91-603

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IN THE
Supreme Court of the United States
OCTOBER TERM 1991

PEPSICO, INC., LAWRENCE DICKIE, JAMES ENGLISH, JUDY NORMAN-DAVIS, RICHARD CAMPBELL, AND SHARON SCHRODER,

Petitioners,

v.

WILLIAM T. USELTON, ET AL.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Court of Appeals Decision below conflicts with this Court's Decision in *International Bhd. of Teamsters, etc. v. Daniel,* 439 U.S. 551 (1979), in holding that an employee who has agreed to participate in a compensation program which, among its components, includes a wage forgiveness and an employee stock ownership plan, has purchased a security under 15 U.S.C. sections 77b(1) and 78c(a)(10) (1988), when (1) the employee participated in the compensation program without expectation of profit but solely in order to provide financial assistance to his troubled employer, and (2) the employee is neither required nor permitted to make contributions to the employee stock ownership plan.

2. Whether the Court of Appeals Decision below conflicts with this Court's Decision in *Daniel* in holding that an employee benefit plan already explicitly subject to regulation under the Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (1988), also is subject to regulation under Federal Securities Laws because the ERISA regulation is not a duplication of regulation under the Securities Laws.

LIST OF PARTIES

The parties to the proceeding below were Petitioners PepsiCo, Inc.,[1] Lawrence Dickie, James English, Judy Norman-Davis, Richard Campbell, and Sharon Schroder, which were defendants, appellees and cross-appellants.

Other parties to the proceedings were Commercial Lovelace Motor Freight, Inc., M.T. Alcox, W.D. Persavich, C.C.

[1]Pursuant to Rule 29.1 of the Rules of this Court, petitioner PepsiCo states that it has no parent companies. Its subsidiaries (other than wholly-owned subsidiaries) are: Alpac Corp.; American Business Computer Corp.; Arnott's Snack Foods; Beijing Pepsi-Cola Beverage Company Ltd.; Britvic Holdings Limited; Cal-Pepsi, Inc.; Candy Pops S.R.L., C.V.; Channel Island Beverage Co., Inc.; Corina Snacks; Delta Beverage Group, Inc.; Dulsa S.R.L., C.V.; Equipos y Deportes Exclusivos, S.A. de C.V.; Grupo Gamesa; Guangzhou Flavours Development Corp.; Guangzhou Hua Chang Toy Co. Ltd.; Gurlin; Hungaropet KFT; Kentucky Fried Chicken (Great Britain) Limited; Laurel Packaging, Inc.; Lindsey Bottling Company, Inc.; Lindsey Holding Company, Inc.; Nanchang Pepsi-Cola Beverage Company Ltd.; Orion Frito-Lay Corporation; PAI S.P.A.; Penn-Chesapeake Associates, Inc.; PepsiCo (U.K.) Pension Trust Limited; Pepsi-Cola Allied Bottlers, Inc.; Pepsi-Cola Bottling Co. of Bend; Pepsi-Cola Bottling of Northern California; Pepsi-Cola Bottling of Rosenburg; Pepsi-Cola General Bottlers, Inc.; Pepsi-Cola Products Myanmar Limited; Pepsi-Cola Products Phillippines, Inc.; Pepsi Foods Private Ltd.; Pizza Moscow; President Frito-Lay Corp.; President Pepsi-Cola Bottling Co. Ltd.; Productos Industrialzados Saltillo, S.A.; P.T. Indofood Frito-Lay Corp.; Serm Suk Co. Ltd.; Seven-Up Andino S.A.; Shanghai McCormick Seasoning & Foodstuffs Company Ltd.; Shanghai Pepsi-Cola Beverage Company Ltd.; Siam Snack Company, Ltd.; Sportmex Internacional S.A. de C.V.; Tasty Foods Egypt SAE; The Hostess-Frito-Lay Company; Uzay Gida Sanayive Picaret A.S.; Williamette Beverage Co.; Blanchard, S.A.; Frito-Lay Venezuela S.A.; LAG Enterprises, Inc.; Wedel S.A.; Chai Tai-KFC Investment Co. Ltd.; CP-KFC Development Company Limited (Thailand); International Process Foods; Kentucky Fried Chicken Beijing Limited; Kentucky Fried Chicken Espana, S.A.; Kentucky Fried Chicken Japan Ltd.; Kentucky Fried Chicken Management Pte. Ltd.; Shanghai Kentucky Fried Chicken Company Limited; Pizza Hut do Brasil Restaurantes Ltda.; Pizza Hut del Distrito, S.A. de C.V.; Pizza Hut (U.K.) Ltd.; Empresas Gamesa, S.A. de C.V.

McCracken, N.L. Ingrum, H.J. Hill, G.W. McIntyre, Transportation Equipment Services, Inc., Edward L. Mulcahy, Phillip White, and H.F. Poston, which were also defendants and appellees.

The other parties to the proceedings below were the respondents, who are listed below, which were the plaintiffs, appellants and cross-appellees. The respondents are: William T. Uselton; W.D. Hupp; C.J. Dowling; Kenneth Miles; G.D. Jeffcoat; Jack Wilson; K.D. Witt; Paula Rosa; Johnny S. Hunt; James A. Mason; Robert E. Stuart; Jerry Don Casey; Maurice Uhrmacher; Loyd A. Duncan; Vernon Jordan; Hubert D. Williamson; J.W. Haris; D.L. Haralson; Harvey Leo Hess; Wood G. Ishmael; Harold W. Summers; Charles E. Stockton; Joe C. Gray; Earl G. Jackson; E.L. Whilhock; Melvin Carpenter; Robert T. Keener; Troy G. Carson; Jack L. Blankinship; Carl L. Davidson; J.F. Maxwell; Paul M. Warren; Jay W. Harned; E.H. Coulter; Earl E. White; Cleo C. McDaniel; Bobby F. Stansbury; Bill J. Anderson; Daniel A. Denny; Carl Lee Wilson; Leroy Barrett; James E. Lee; Donald L. Butler; L.W. Gonzales; Daisy "Maurene" Davis; Keith W. Braul; Jerry L. Edgemon; Gilbert L. Robles; Loyd E. Courtney; Hollis M. Mauldin; Johnny L. Johnson; Carmel M. Doern; Tom Thelkekd; T.L. Jones; Kenneth W. Hays; Jackie Jones; William Donley; Howard L. Mitchell; Earl D. Denton; Stanley R. Gomes; Jack P. Rowland; K.L. Billingsley; Earl L. Woffard; D. TD. Frizell; H.W. Richardson; Donald Kendrix; Betty Cox; James M. Woodward; Frank Donald R. Winter; Jack Yarbrough; Finis M. Yocum; Tommy L. Kirkland; John A. Moyshen; Harold Allison; Marion McClelland; Leslie R. Walcher; Lloyd Fortune, Sr.; B.C. Evans; Raymond B. Horn; Leeha McCormick; Pete Wolf; Leon Hancock; William Anderson; Robert G. Porter; Eldon W. Bishop; E.B. Copeland; D.K. Hanshue; E.G. Dedmon; Leslie R. Walcher; Carl L. Holman; Kenneth W. Jackson; Joel Robinson; Charles Pemberton; Bruce O. Smith; T.D. Jack; James T. Johnson; Willie G. Loudermilk;

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PEPSICO, INC., LAWRENCE DICKIE, JAMES ENGLISH, JUDY NORMAN-DAVIS, RICHARD CAMPBELL, AND SHARON SCHRODER,

Petitioners,

v.

WILLIAM T. USELTON, ET AL.,[2]

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners respectfully request that a writ of certiorari issue to review the Decision of the United States Court of Appeals for the Tenth Circuit on the ground that the Decision conflicts with prior decisions of this Court and conflicts as well with decisions of other Courts of Appeal. Rules 10(a) and 10(c) of the United States Supreme Court.

OPINIONS BELOW

The Opinion of the Court of Appeals is reported at 940 F.2d 564 and is included in the Appendix at pp. A-1 to A-42. The Order and Opinion of the District Court containing the Court's findings of fact and conclusions of law after trial is included in

[2]The names of the more than 400 respondents are set forth in the List of Parties.

the Appendix at pp. B-1 to B-18. The Pretrial Order of the District Court delineating the issue to be tried is included in the Appendix at pp. C-1 to C-2.

JURISDICTION

The Judgment of the Court of Appeals was entered on July 12, 1991. This Court has jurisdiction pursuant to 28 U.S.C. section 1254(1) and Rules 10.1(a) and (c) of the Supreme Court Rules. The issuance of the mandate from the Court of Appeals has been stayed by Order of that Court granted in response to Petitioner's motion.

STATUTES INVOLVED

Section 77b(1) of 15 U.S.C. provides:

"When used in this subchapter, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group of index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

Section 78c(a)(10) of 15 U.S.C. provides:

"When used in this chapter, unless the context otherwise requires—

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

STATEMENT OF THE CASE

As of 1989, nearly 10,000 companies utilized some form of employee stock ownership plan ("ESOP"). *Employee Ownership Plans Seen As Way to Protect Workers' Jobs*, Daily Labor Report (BNA) No. 68, at A-4 (April 9, 1991) ("*Employer Ownership Plans*"). These companies employed some 11.5 million Americans. *Id.* Beginning in the 1980's with the successful effort to save Weirton Steel, *see Bauman v. Bish*, 571 F. Supp. 1054 (N.D.W. Va. 1983), and continuing to the present, employee stock ownership plans have been joined with employee wage givebacks as a strategy for saving failing companies. *Employee Ownership Plans*, *supra*, at A-4. Consequently, large portions of major segments of American industry—steel and transportation are notable examples—have been salvaged through the device of restructuring employee compensation packages to substitute portions of the employer's stock for money wages. *Id.* Indeed, some one in ten

steelworkers is currently a participant in a wage forgiveness ESOP initially launched to save a struggling employer. *Id.* This case turns on the question of whether this widespread compensation program shall now become subject to regulation under the Federal Securities Laws.

A. The Commercial Lovelace Compensation Program.

Beginning in June 1984, the management of Commercial Lovelace Motor Freight, Inc. ("CL") presented a compensation program to the employees of its newly acquired subsidiary, Lee Way Motor Freight, Inc. ("Lee Way"). App., pp. B-5, 8. CL had adopted the same Compensation Program for its own employees in 1983. App., p. B-5.

At the time, both Lee Way and CL were deregulated trucking companies which were both operating at a loss. CL management presented the compensation program to Lee Way's employees as a last chance to save Lee Way and the employees' jobs. App., pp. B-8, 9. Specifically, in oral and written presentations, CL represented that: (1) Lee Way had suffered major operating losses and needed to decrease expenses in order to continue operating; (2) the employees needed to agree to a reduction in their wages in order to save the company and their jobs; (3) the reduction in wages would help reduce Lee Way's expenses; and (4) without overwhelming employee participation in the Compensation Program, the Company would probably fail. App., pp. B-8 to 10.

The trial testimony of former Lee Way employees established, and the District Court found, that none of the plaintiffs participated in the Compensation Program in order to realize a profit or otherwise to invest in CL.[3] App., pp. B-10, 11. The non-union Lee Way employees who participated did so because it was a

[3]Nevertheless, the Court of Appeals found, *as a matter of law,* that the employees' decision to participate in order to "save the company, save our jobs" was consistent with a traditional investment motive. App., p. A-19.

condition of their continued employment. App., p. B-10. The union employees who participated did so because they viewed participation as the only possible avenue for saving their jobs. App., p. B-11.

The District Court also found that the Compensation Program had three components: (1) wages of participating employees would be reduced by 17.355%; (2) CL would institute a cash profit-sharing bonus plan; and (3) participants would become eligible to participate in an existing CL employee stock ownership plan ("CL ESOP"). App., p. B-6. Fifteen months earlier, CL presented the Compensation Program to its own employees. When the Program was first implemented at CL in March of 1983, CL had fully funded the ESOP component of the Compensation Program by issuing 4,001,000 shares of its common stock to the CL ESOP Trustee. App., pp. B-5 to 7. CL received, in exchange, a note from the Trustee, and that note, in turn, was funded by CL. App., pp. B-6 to 7.

The CL ESOP was thus fully funded from its inception. App. pp. B-6 to 8. While Lee Way employees who participated in the CL Compensation Program had their wages reduced by 17.355%, not a penny of that wage reduction was used to fund the ESOP trust, and any allocation of CL stock made to an employee was based upon a formula that was unrelated to the extent of any employee's wage forgiveness. App., pp. A-11, B-7. The amount of the wage reduction was not paid into the CL ESOP in any way. App., pp. B-8, 10. Indeed, the terms of the CL ESOP expressly precluded such payments, providing that "no participant shall be required or permitted to make contributions to the [ESOP] trust." App., p. B-8. The wage reduction simply resulted in a reduction of Lee Way's operating expenses. App., p. B-10.

B. The Proceedings Below.

In 1984, 426 former Lee Way employees brought this action alleging violation of various provisions of the Federal Securities

Laws,[4] violation of various provisions of Oklahoma securities laws, and common law fraud. Jurisdiction was premised upon 15 U.S.C. sections 77v(a) and 78aa. The plaintiffs claimed that their participation in the CL ESOP was voluntary and that the CL ESOP was a contributory plan. On this basis, they claimed that their participation in the CL ESOP constituted a security in the form of an investment contract. The District Court segmented the case for trial on the limited issue of whether the employees' participation in the CL ESOP constituted a security under the Federal Securities Laws, 15 U.S.C., §§ 77b(i), 78c(a)(10) (1988). App., pp. B-1, 2, C-1, 2.

Before trial, the District Court ruled that in order to establish that participation in the CL ESOP was a security, the plaintiffs would have to prove that the ESOP was a voluntary, contributory plan and that it otherwise fit within the definition of a security. App., p. C-1. The Court also ruled that (a) to establish that the plan was contributory, the employees had to make payments into the CL ESOP, and (b) a mere showing that the employer obtained a reduction of its wage expense would not make the plan contributory. App., pp. C-1 to 2.[5]

After a three day trial, the District Court entered judgment for the defendants. App., p. B-12. It found that the CL ESOP was not contributory: "No employee contributions were permitted to be made to the plan, and in fact none were made." App., p. B-11. It further found that the employees' decision to participate in the plan "was overwhelmingly non-voluntary" and that the employees' participation in the plan "had virtually no characteristics of an investment decision actionable under federal securities law."

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[4]Sections 12(1), 12(2), 15, and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 771(1), 771(2), 77o, 77q(a), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

[5]Though plaintiffs tried to meet this standard at trial, the District Court correctly found that they failed completely in that effort. App., pp. B-11 to 12.

App., p. B-11. Based upon its finding that the employees' participation in the CL ESOP did not constitute the purchase of a security, the Court entered judgment in favor of the defendants on plaintiffs' federal securities claims and dismissed their remaining claims for lack of independent federal jurisdiction. App., p. B-12.

Respondents appealed to the United States Court of Appeals for the Tenth Circuit. The Tenth Circuit reversed the judgment of the District Court, holding, *as a matter of law*, that the plan was both contributory and voluntary, and that participation in the ESOP constituted an investment contract under *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946). The Court of Appeals held that even though the employees did not contribute any portion of their wages to the CL ESOP, the employees' forgiveness of a portion of their wages in exchange for the opportunity to participate in the CL ESOP and the profit-sharing plan would be deemed a contribution to the CL ESOP for the purpose of determining whether participation in the plan constituted an investment contract. App., p. A-18. The Court further concluded, *as a matter of law*, that the employees made a voluntary investment decision in participating in the CL ESOP notwithstanding the employees' own testimony that they participated in the Compensation Program in order to save their jobs. The Tenth Circuit held that the employees' decision to join the Compensation Program in order to save their jobs is "consistent with a traditional investment motive." App., p. A-19. Based upon its determination that the CL ESOP was both voluntary and contributory, and that the other elements of the *Howey* investment contract test were satisfied, the Court of Appeals held that the employees' participation in the CL ESOP constituted an investment contract and, hence, a security.

The Court of Appeals then considered whether existing ERISA regulation of this type of employee benefit plan should remove these instruments from the reach of Federal Securities Laws pur-

suant to doctrine established by this Court in *International Bhd. of Teamsters, etc. v. Daniel*, 439 U.S. 551 (1979). Relying on its own decision in *Holloway v. Peat, Marwick, Mitchell & Co.*, 879 F.2d 772 (10th Cir. 1989), *vacated*, 110 S. Ct. 1314 (1990), *reaffirmed*, 900 F.2d 1485 (10th Cir. 1990), the Tenth Circuit held that because ERISA did not "*duplicate*", App., p. A-36, the protection afforded under the Federal Securities Laws, the Securities Laws would apply to this type of employee benefit plan.

REASONS FOR GRANTING THE PETITION

The Decision of the Tenth Circuit to apply the Federal Securities Laws to an employee's participation in an employee benefit plan that is part of the employee's compensation package plainly conflicts with two parts of this Court's Decision in *International Bhd. of Teamsters, etc. v. Daniel*, 439 U.S. 551 (1979). First, in *Daniel,* this Court held that an employee's participation in a benefit plan that was simply one part of the employee's overall compensation package did not constitute a security because the employee's participation in the plan did not constitute an "investment of money" within the meaning of *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946). *Daniel*, 439 U.S. at 559-61. Second, this Court in *Daniel* declined to treat a benefit plan as a security subject to Federal Securities Laws in deference to the regulatory scheme embodied in ERISA, because "[u]nlike the Securities Acts, ERISA deals expressly and in detail with pension plans." *Id.* at 569.

The Tenth Circuit's decision is in clear conflict with *Daniel*'s reasoning on both of these points, and also conflicts with the decisions of other United States courts of appeal. Review of the Decision below is vital because that Decision will adversely impact thousands of companies that have adopted similar plans.

I. THE COURT OF APPEALS DECISION—THAT PARTICIPATION IN AN EMPLOYEE BENEFIT PLAN WHICH IS PART OF AN EMPLOYMENT COMPENSATION PACKAGE CONSTITUTES AN INVESTMENT IN A SECURITY—CONFLICTS WITH THIS COURT'S DECISION IN *DANIEL* AND CONFLICTS AS WELL WITH DECISIONS IN OTHER COURTS OF APPEAL.

A transaction is an investment contract, and hence a security, for purposes of the Federal Securities Laws, if it involves "an investment of money in a common enterprise with profits to come solely from the efforts of others." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946). In considering whether an employee's participation in a benefit plan constitutes an "investment of money," *Daniel* was crystal-clear that the scope of the Federal Securities Laws must be determined "in light of 'the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties.' " *Daniel*, 439 U.S. at 558 (quoting *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 851-52 (1975)). Accordingly, *Daniel* carefully evaluated the "economic realities" of the transaction, noting, for example, that an employee participant in the *Daniel* benefit plan made "no payment into the pension fund. He only accepts employment, one of the conditions of which is eligibility for a possible benefit on retirement." *Daniel*, 439 U.S. at 559. Examining "the entire transaction through which [the employee] obtained a chance to receive pension benefits," *id.*, this Court concluded that no "investment of money" had been made:

> Only in the most abstract sense may it be said that an employee 'exchanges' some portion of his labor in return for these possible benefits. He surrenders his labor as a whole, and in return receives a compensation package that is *substantially* devoid of aspects resembling a security. His decision to accept and retain covered employment may have only an attenuated relationship, if any, to perceived investment possibilities of a future pension. Looking at the economic realities it seems clear that an employee is selling his labor *primarily* to obtain a livelihood, not making an investment.

Daniel, 439 U.S. at 560 (emphasis added).[6]

The Court of Appeals failed to accept that the "economic realities" of the "compensation package" in this case demonstrate that, as in *Daniel,* the employment decisions made by these plaintiffs did not constitute an "investment of money." The Lee Way employees, just like the employees in *Daniel,* paid no cash or other property into the CL ESOP. *Compare* App., pp. B-8, 10, 11 *with Daniel,* 439 U.S. at 554. Indeed, as already noted, the ESOP prohibited the employees from making contributions to the plan. App., p. B-8. The wage forgiveness component of the Compensation Program simply reduced Lee Way's operating expenses. Each employee's respective interest in the CL ESOP was unrelated to the amount of his wage forgiveness. App., pp. B-7, 10.

Furthermore, the participating Lee Way employees testified, and the District Court found, that they themselves did not view

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[6]Contrary to the Decision below, and over a period of some 12 years, numerous Federal courts have understood *Daniel* to establish that an employee's participation in an employee benefit plan which is part of the employee's compensation package does not constitute an investment in a security under the federal securities laws. *See, e.g., Coward v. Colgate-Palmolive Co.,* 686 F.2d 1230 (7th Cir. 1982), *cert. denied,* 460 U.S. 1070 (1983) (employee retirement pension plan); *Black v. Payne,* 591 F.2d 83 (9th Cir.), *cert. denied,* 444 U.S. 867 (1979) (retirement pension plan); *Cunha v. Ward Foods, Inc.,* 545 F. Supp. 94 (D.Haw. 1982). *aff'd in part and rev'd in part on other grounds,* 804 F.2d 1418 (9th Cir. 1986) (contributory noncompulsory benefit plan); *O'Neil v. Marriott Corp.,* 538 F. Supp. 1026 (D. Md. 1982) (profit sharing, savings and retirement plan); *Tanuggi v. Grolier, Inc.,* 471 F. Supp. 1209 (S.D.N.Y. 1979) (contributory noncompulsory pension plan); *Newkirk v. General Electric Co.,* [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,216 (N.D. Cal. 1979) (contributory noncompulsory pension plan). *See also In re Crippin,* 877 F.2d 594, 597 (7th Cir. 1989) (in deciding whether employees could treat their agreements to participate in an ESOP as an executory contract and reject that contract in bankruptcy, the 7th Circuit held that the ESOP was part of the employer's compensation system and thus an integral part of the entire employment relationship).

participation in the compensation program as an investment opportunity. Rather, they made an employment decision, viewing the program as the "only possible avenue of saving their jobs." App., p. B-11. The District Court's factual findings clearly and correctly establish that the wage forgiveness and the CL ESOP were merely components of a compensation package which Lee Way employees chose to accept in order to preserve their jobs. App., pp. B-10 to B-12. Thus, as in *Daniel,* these employees were not "investor[s choosing] to give up a specific consideration in return for a separable financial interest with the characteristics of a security." *Daniel,* 439 U.S. at 559. Rather, as in *Daniel,* each of the plaintiffs here was merely "selling his labor primarily to obtain a livelihood, not making an investment." 439 U.S. at 560.

In square conflict with *Daniel's* view that an employee's surrender of his labor must be viewed "as a whole", the Court of Appeals carved out those portions of the employees' compensation package that constituted the ESOP and the wage forgiveness, and characterized the wage forgiveness as a "contribution" to the employee benefit plan. App., pp. A-17 to 19. Moreover, the Court of Appeals' analysis conflicts squarely with another ruling of *Daniel,* where this Court rejected the argument that the employees "invested" in the pension plan by permitting part of their compensation to take the form of a deferred benefit by participation in an employee benefit plan. *Daniel,* 439 U.S. at 559.

The Court of Appeals sought, nonetheless, to synthesize an investment decision here by stressing that the union employees who joined the Compensation Program had to individually elect to do so, App., pp. A-18 to 20, even though, as the District Court found, they were merely "electing" to save their jobs. App., pp. B-11. In reaching this conclusion, the Court of Appeals contrasted the situation of these union employees with that of Lee Way's salaried management employees, who were not required to formally consent to the Program. The Court of Appeals acknowledged that participation by the non-union employees in the com-

pensation program (including the ESOP) was a condition of their continued employment, App., p. A-8 n.1, and, hence, implicitly acknowledged that these employees had not made an investment of money for the purposes of the securities laws.

But it is inexplicable why a decision to sign a piece of paper indicating a "choice" to save one's job is any more of an "investment of money" than a naked decision to accept a wage cut in the hope that the job would be preserved. The Tenth Circuit's fixation on the form of consent caused it to ignore the issue which *Daniel* made the litmus in such cases—the "economic reality" of the transaction. Here, the fact is that all of the Lee Way employees—union and non-union—who participated in the ESOP did so only because they thought that the Compensation Program as a whole had a chance of saving their jobs. The fact that some employees memorialized that hope by signing a form and others did so simply by remaining with the Company does not mean that the "economic reality" of the transaction was any different for the two groups. In both cases—as the District Court found and as the plaintiffs themselves candidly admitted—the employees were making decisions about the terms and conditions under which they were prepared to sell their labor; not about the likely profitability of an investment in Commercial Lovelace stock. *Daniel* is clear and unequivocal in holding that such decisions do not amount to an investment of money.[7]

[7]The Court of Appeals noted that the employees' desire to save their job was "consistent with a traditional investment motive because each is concerned with and makes an investment in the future of the company." App., p. A-19. By this logic, however, every employment decision is an investment, since all employees are "concerned with and make an investment in" their employer's survival and prosperity. Moreover, the rule in *Daniel* is to the contrary. There, this Court held that a compensation package did not become a security so long as the employee is "selling his labor *primarily* to obtain a livelihood." 439 U.S. at 560 (emphasis added). The mere fact that an employee may have investment motives which are "consistent" with his "primary" interest in obtaining a livelihood does not, under *Daniel* and contrary to the Court of Appeals' ruling, transform an employment decision into an investment decision.

The Tenth Circuit's decision not only conflicts with this Court's decision in *Daniel,* but it also conflicts with the decisions of other courts of appeals that have held that participation in an employee benefit plan that is part of a compensation package does not constitute an investment in a security. *Coward,* 686 F.2d at 1236-37; *Black,* 591 F.2d at 87-88. In both *Coward* and *Black,* the employees, like the Lee Way employees, participated in the benefit plan as a result of an employment, as opposed to an investment, decision. *Id.* Accordingly, the Seventh and Ninth Circuits, consistent with *Daniel,* concluded that the employees' participation in the plans did not constitute a security. The Tenth Circuit, by its Decision in this case, has departed from this controlling precedent.

Although numerous cases have applied *Daniel* to different types of employee benefit plans, this case is the first in which a court of appeals has addressed the specific question of whether a wage forgiveness ESOP comprises the purchase of a security for securities law purposes. Of the lower courts to address this question, two have concluded, contrary to the decision below, that a wage forgiveness coupled with participation in an ESOP does not constitute an investment of money. *See Childers v. Northwest Airlines, Inc.,* 688 F. Supp. 1357, 1363 (D. Minn. 1988), and *Bauman v. Bish,* 571 F. Supp. 1054, 1064 (N.D.W. Va. 1983). In addition, the United States Court of Appeals for the Seventh Circuit, in determining (for bankruptcy purposes) whether wage-forgiveness ESOPs are executory contracts to purchase securities, has concluded that they are not, and that they should be treated as nothing more than a portion of an employee's indivisible compensation package. *In re Crippin,* 877 F.2d 594, 597-98 (7th Cir. 1989). In contrast, two other District Courts have found, consistent with the Decision below, that an investment of money is made under these circumstances. *Harris v. Republic Airlines, Inc.,* [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,772 (D.D.C. May 18, 1988), and *Hood v. Smith's Transfer Corp.,* 762 F. Supp. 1274 (W.D. Ky. 1991).

The Tenth Circuit panel sought to harmonize these decisions by reliance on the fact that, in *Daniel*, this Court noted that the benefits plan before it was a noncontributory, compulsory pension plan. 439 U.S. at 559-61. Though this structural characteristic of the *Daniel* plan was treated by *Daniel* merely as evidence demonstrating the absence of an investment of money, *id.*, the panel below, App., pp. A-15 to 16, following the SEC and an earlier Tenth Circuit decision, Securities Act Release No. 33-6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1052 (Feb. 1, 1980); *Salazar v. Sandia Corp.*, 656 F.2d 578 (10th Cir. 1981), treated this evidentiary analysis as a firm rule of law. Thus, the Tenth Circuit created a matrix of benefit plans to determine whether a security can be found depending on the plans' structural characteristics: that is, a benefit plan would be deemed not to be a security if it is either noncontributory or compulsory, but it would be deemed to be a security if it is contributory and noncompulsory. App., pp. A-15 to 16.[8]

Using this analysis, the Tenth Circuit distinguished between *Bauman* and *Childers* on the one hand and *Harris*, *Hood* and this case on the other, by noting that, in the former cases, the employees had merely voted in favor of amended collective bargaining agreements which authorized wage forgiveness ESOP's while, in the latter cases, the employees had individually consented to the ESOPS. App., A-24 n.12 (distinguishing *Childers* and *Bauman* cases). This distinction, it was argued, made the decisions in *Bauman* and *Childers* "involuntary," while leaving the decision in this case "voluntary." *Id.*

Such distinctions, however, cannot be squared with *Daniel's* mandate to focus on the "economic realities" of a putative securities transaction; substituting in the place of a careful analysis of

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[8]This conclusion conflicts with the Seventh Circuit's holding in *Coward*, 686 F.2d at 1236-37. The employee benefit plan there at issue was a contributory, voluntary plan. Yet the Seventh Circuit found that it did not constitute a security.

a transaction's substance, a rote application of the structural factors that happened to characterize the plan that was before this Court in *Daniel*. The result is a set of distinctions that turn the pragmatic analysis of *Daniel* on its head; for, in the wake of the Decision below, an employee who votes in favor of accepting a compensation package with a securities component (*Childers* and *Bauman*) or who simply remains on the job after his employer adopts such a plan (App., p. A-8 n.1) has *not* purchased a security, but an employee who formally confirms his acceptance of such a package (App., pp. A-17 to 18, *Harris* and *Hood*) has bought a security. Such would be the result, of course, unless the issue is being evaluated for bankruptcy purposes, in which case the security purchased by the employee who formally consents to the ESOP somehow reverts back into a compensation plan. (*Crippin*.) Such distinctions serve no regulatory, economic or business purpose,[9] and are contrary to the *ratio decidendi* of this Court's Decision in *Daniel*.

II. THE COURT OF APPEALS DECISION—WHICH SUBJECTS EMPLOYEE BENEFIT PLANS ALREADY EXPLICITLY COVERED BY ERISA TO FEDERAL SECURITIES LAW COVERAGE ON THE GROUND THAT ERISA'S PROVISIONS DO NOT DUPLICATE SECURITIES LAW PROVISIONS—CONFLICTS WITH THIS COURT'S DECISION IN *DANIEL* AND ALSO CONFLICTS WITH DECISIONS IN OTHER CIRCUITS.

The employee benefit plan that was part of the Compensation Program is regulated by ERISA. App., pp. A-12, B-6. In *Daniel*, this Court held that the existence of ERISA—"comprehensive legislation governing the use and terms of employee pension

[9]Indeed, the Tenth Circuit opinion ultimately acknowledges that the distinctions it draws are less the product of a set of rational principles common to these decisions and more the result of the Tenth Circuit's disagreement with the decisions which have declined to treat wage forgiveness employee benefit plans as securities. App., p. A-24 n.12.

plans"—undercut the argument for extending the Federal Securities Acts to the employee benefit plan before it. *Daniel*, 439 U.S. at 569-70. This Court noted that ERISA, unlike the Securities Acts, deals expressly with such plans, *id.* at 569, and concluded that whatever benefits employees might derive from coverage by the Securities Acts are now provided in more definite form through ERISA. *Id.* at 570.

Similarly, in *Marine Bank v. Weaver*, 455 U.S. 551 (1982), this Court concluded that a certificate of deposit issued by a federally regulated bank was not a security because deposits in federally regulated banks are already subject to specific extensive federal regulation. *Marine Bank*, 455 U.S. at 557-59. This Court concluded that it was unnecessary to subject issuers of bank certificates of deposit to liability under the Federal Securities Laws since federal banking laws "abundantly protected" the holders of bank certificates of deposit. *Id.* at 559.

Consistent with *Daniel* and *Marine Bank*, the Fourth Circuit, in determining whether the Federal Securities Laws applied to a certificate of deposit, considered whether the transaction was governed by a comprehensive scheme of regulation. *Tafflin v. Levitt*, 865 F.2d 595, 598-99 (4th Cir. 1989). Because the financial instrument in issue was subject to a comprehensive scheme of regulation, *Tafflin* held that the certificate of deposit was not a security. *Id.* at 599. It was not necessary that the regulatory scheme mirror or duplicate the securities laws. Indeed, the regulatory system need not even be effective. *Id.* Rather, it was only necessary that the transaction be covered by a comprehensive regulatory scheme applicable to the specific instrument. *Id. See also Wolf v. Banco Nacional de Mexico, S.A.*, 739 F.2d 1458 (9th Cir. 1984), *cert. denied*, 469 U.S. 1108 (1985) (foreign certificate of deposit not a security where certificates are subject to extensive regulation by Mexican government).

The Tenth Circuit, however, rejected the rule of law of *Daniel* and *Marine Bank* as construed in other circuits, and held Federal

Securities Law to govern unless ERISA "*duplicates*" the protection offered to plaintiffs by the Securities Acts. App., p. A-36. In so holding, the Decision below relied on *Holloway v. Peat, Marwick, Mitchell & Co.*, 879 F.2d 772 (10th Cir. 1989), which expressly disagreed with the analysis of *Tafflin* and *Wolf. Id.* at 785 n.11. In *Holloway,* the Tenth Circuit misapplied *Marine Bank* and ruled that an instrument covered by an alternative regulatory scheme would be exempted from securities regulation only where the alternative regulatory protections duplicated the protections existing under the Securities Laws. The requirement of duplication, however, appears nowhere in the decisions of this Court.[10] Rather, the rule of law established by this Court in *Daniel* and *Marine Bank* merely requires an assessment of whether or not the transaction is covered by a comprehensive regulatory scheme.

The rule established by this Court in *Daniel* and *Marine Bank* is right. It acknowledges and defers to the fact that Congress often chooses to regulate different substantive areas differently. To insist on applying the regulatory apparatus of the Federal Securities Laws whenever other specifically applicable statutes do not "duplicate" the regulatory scheme necessarily means that securities principles will be applicable to transactions even when Congress intended to regulate them differently and by more finely drawn regulatory controls.

Here, the Court of Appeals acknowledged the applicability of ERISA to this transaction, but held that a Federal Securities Law

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[10]In *Marine Bank* this Court did recognize that the relevant banking regulations provided the purchasers of certificates of deposit with *essentially* all of the protection that could reasonably be expected if the securities laws were applied. That conclusion is then identified as a reason why the regulatory "context" in which certificates of deposit are offered precludes additional regulation under the securities laws. *Marine Bank,* 455 U.S. at 554-55. *Marine Bank* does not, however, hold that the existence of such comprehensive and duplicative protections are the sole or even a necessary test for determining whether the regulatory "context" precludes coverage by the Securities Acts.

cause of action should nonetheless be found, since, in the Tenth Circuit's view, ERISA did not create a remedy under these circumstances. App., pp. A-32 to A-36. But there is no reason to believe that Congress wanted to subject employers seeking to restructure their compensation obligations to the same disclosure burdens as persons seeking to raise capital by the issuance of securities. Rather, the focus of the Securities Acts is on the capital markets, not employment decisions. *See United Hous. Found., Inc. v. Forman,* 421 U.S. 837, 849 (1975). Thus, as this Court has recognized, "Congress' purpose in enacting the securities laws was to regulate *investments. . . .*," *Reves v. Ernst & Young,* 494 U.S. 56, 110 S. Ct. 945, 949 (1990) (emphasis in original), and, in passing the Securities Laws, Congress did not "intend to provide a broad federal remedy for all fraud." *Marine Bank,* 455 U.S. at 556.

If, as the Tenth Circuit held, Congress' comprehensive regulation of compensation programs did not contemplate the sort of claim at issue in this case, that policy decision should be respected, not upset by a judicial decision to import such a claim from the Securities Acts. The Tenth Circuit's ruling to the contrary is in direct conflict with this Court's decision in *Daniel.*[11]

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[11]The impact of the Tenth Circuit's decision is not limited to the parties before this Court. The hundreds of thousands of jobs that have been (and will be) saved by wage-forgiveness ESOPs have typically been rescued when the employers involved were in sufficiently great financial distress that their very existence was threatened. *Employees Ownership Plans, supra,* at A-4. Under such circumstances, the need to act decisively, flexibly and with dispatch is at a premium. Hence, a rule of law which, like the rule adopted below, burdens these decisions with an additional layer of federal regulatory control, and the concomitant expense, necessarily carries with it significant adverse consequences for the ability of employers to stay in business and employees to save their jobs.

CONCLUSION

Only this Court can resolve the issue of whether participation in an employee benefit plan constitutes a security, and only this Court can correct the Tenth Circuit's error in extending the Securities Acts to transactions which Congress intended to be governed by ERISA. For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

PUBLISH

United States Court of Appeals

TENTH CIRCUIT

WILLIAM T. USELTON; W.D. HUPP;
C.J. DOWLING; KENNETH MILES;
G.D. JEFFCOAT; JACK WILSON; K.D. WITT;
PAULA ROSA; JOHNNY S. HUNT;
JAMES A. MASON; ROBERT E. STUART;
JERRY DON CASEY, MAURICE UHRMACHER;
LOYD A. DUNCAN; VERNON JORDAN;
HUBERT D. WILLIAMSON; J.W. HARIS;
D.L. HARALSON; HARVEY LEO HESS;
WOOD G. ISHMAEL; HAROLD W. SUMMERS;
CHARLES E. STOCKTON; JOE C. GRAY;
EARL G. JACKSON; E.L. WHILHOCK;
MELVIN CARPENTER; ROBERT T. KEENER;
TROY G. CARSON; JACK L. BLANKINSHIP;
CARL L. DAVIDSON; J.F. MAXWELL;
PAUL M. WARREN; JAY W. HARNED;
E.H. COULTER; EARL E. WHITE;
CLEO C. MCDANIEL; BOBBY F. STANSBURY;
BILL J. ANDERSON; DANIEL A. DENNY;
CARL LEE WILSON; LEROY BARRETT;
JAMES E. LEE; DONALD L. BUTLER;
L.W. GONZALES; DAISY "MAURENE" DAVIS;
KEITH W. BRAUL; JERRY L. EDGEMON;
GILBERT L. ROBLES; LOYD E. COURTNEY;
HOLLIS M. MAULDIN; JOHNNY L. JOHNSON;
CARMEL M. DOERN; TOM THELKEKD;
T.L. JONES; KENNETH W. HAYS;
JACKIE JONES; WILLIAM DONLEY;
HOWARD L. MITCHELL; EARL D. DENTON;
STANLEY R. GOMES; JACK P. ROWLAND;
K.L. BILLINGSLEY; EARL L. WOFFARD;
D. TD. FRIZELL; H.W. RICHARDSON;
DONALD KENDRIX; BETTY COX;
JAMES M. WOODWARD;

Nos. 88-1253
&
88-1750

FRANK DONALD R. WINTER;
JACK YARBROUGH; FINIS M. YOCUM;
TOMMY L. KIRKLAND, JOHN A. MOYSHEN;
HAROLD ALLISON; MARION MCCLELLAND;
LESLIE R. WALCHER; LLOYD FORTUNE, SR.;
B.C. EVANS; RAYMOND B. HORN;
LEEHA MCCORMICK; PETE WOLF;
LEON HANCOCK; WILLIAM ANDERSON;
ROBERT G. PORTER; ELDON W. BISHOP;
E.B. COPELAND; D.K. HANSHUE;
E.G. DEDMON; LESLIE R. WALCHER;
CARL L. HOLMAN; KENNETH W. JACKSON;
JOEL ROBINSON; CHARLES PEMBERTON;
BRUCE O. SMITH; T.D. JACK;
JAMES T. JOHNSON;
WILLIE G. LOUDERMILK;
RAYMOND HORN; GEORGE C. TSOODLE;
GEROLD L. GOAD; B.J. BURRELL;
D.Y. QUALINE; FRANCES M. MCKYE;
ALONZO ANDERSON; HOARCE E. REEVES;
BETTY MOORE; BILLY R. JENKINS;
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CLARENCE BURNS; JOHN L. KNAPP;
RAMON L. WOLFE; W.A. SMITH;
ALAN PRUDHOME; JAMES E. THOMPSON;
HENRY S. BAXTER; PATSY R. BROCK;
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BYRON A. BOUCHELLE; CARL F. DAVIS;
JERRY I. POINDEXTER; LEE ROY HOUSTON;
CLINTON H. REYNOLDS; NIB E. HILL;
DAVID R. HINES; C.G. OLSON;
CLEOPHOS FROST; BOBBY G. DECKER;
JAMES LONG; LORITA A. GOYA;

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&
88-1750

WAYNE T. WELLS; GERALD A. LUTON;
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OPAL LEE BROUSSARD; HOMER KIMBLE;
JERRY NOHNAGER; JUDY A. ROGERS;
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JOHN WILLIAM EDWARDS;
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CARL HOLIDAY; DOUGLAS MESSEL;
DIANE J. TRIGG; TOMMY A. HOWARD;
NORVELL LANCASTER; BOBBY BOWLING;
P.J. WARREN; ROBERT C. ANDERSON;
DOYLE C. ADAMS; GLENN D. CHRISTIANS;
WILLARD TERRY; BILL STEWART;
JIMMY KING; RICHARD BORNE;
JOHNNY WARMOTH; FRANKLIN A. NIELEY;
CHARLES NORTON; GLEN LAYTON;
LEO THOMPSON; D.L. LOMAN;
MARLAND GLOVER; BOBBY BENNETT;
JERRY CHRONISTER; LAWRENCE WHITE;
DONALD FITZ; ODIS WARD;
DONALD T. KENDRIX; RUEL L. MONROE;
RANDALL JOHNSTON; DOUGLAS WEBB;
ROGER L. SMITH; BENNY SHUMWAY;
BOBBY JOHNSON; THEAL CREWS;
ARNETT RICHARDSON;
JUNIOR LEE GOLDEN; JIM BOB KEITH;
BOB L. WILKERSON; JERRY R. KENNEDY;
JAMES L. FREEMAN; MARVIN E. MEEK;
LEROY GRAY; LEROY HILL;
LEALUS THOMAS; A.W. BARNETT;
DONALD L. MAYFIELD; JIMMIE MASTERS;
JMWA E. POERWE; JAMES E. YOUNG;

Nos. 88-1253
&
88-1750

RICKEY D. ALLEN; WILLIAM W. PARTIN;
JAMES E. VAP; EDITH J. VAP;
JOHN REYNOLDS; ARTHUR GOLDEN;
JOE C. NIXON; WILLIE JOSEPH; JOHN H. HEIL;
DONALD H. BRECHINSEN; JAMES ALTIZEN;
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E. FERRELL BUSSING; JIMMIE L. WILLIAMS;
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KAREN NYDICK; GEROLD WAGNER;
L.V. FOREMAN; DON LEPLEY; E.J. FIDLER;
CLAUDE W. WOELEY; FRED M. SILVER;
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PAUL GOODMAN; RONALD C. DAUDILL;
WILLIAM P. DODD; DENNIS S. CREWS;
WILLIS D. KEESEE; JERRY D. BASS;
R.T. SKELTON; DELBERT D. UTSLER;
DON E. BAILEY; HOWARD WHITTENBERG;
MARCIA C. LONG; A.C. PHILLIPS;
JO ANN MARTIN; LEON COMBS;
JERRY C. FORBES; J.R. BISHOP;
BILLY REEVES; FARRELL J. PICKENS;
JAMES RICHARD HOWELLS;
LAWRENCE SHELTON; CHARLES HUCKABEE;
JMWA AXHEOWSWE; THOMAS JARAMILLO;
J. DAVID SMITH; W.T. YOUNG;
CARL H. DAVISON; SHARON KEY HARRIS;
LEW F. FRESONKE; JOE KNAPP;
LESLEY E. CHAPMAN; R.D. BIVINS;
GEORGE W. BARTON; MARION A. NEAL;
REBECCA CRAWFORD;
DEATRON I. MORGAN; W.H. NEVELS;
JIM OLIVER; CLARENCE E. SMITH;
ROBERT WILSON; LINDA LEKAWSKI;
MICHAEL FUNDSTEIN; JERRY L. BENDER;
WILLIAM D. BEERY; DONALD M. LARSON;
WILLIAM J. AZLIN; DWIGHT W. ROGERS;
JUDY A. ROGERS; WALTER R. LEWIS;
CHARLES HUCKABOY; BARBARA HARWELL;
REBECCA PEARSON; MOLLY HOFFMAN;

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PATRICIA MCCANLIES; K.E. STERRETT;
THURMAN B. NELSON; NELDA M. CARROLL;
JOHNNY WALLACE;
GUADALUPE RODRIGUEZ;
RAYMOND DAVEY; L.V. DAVIS;
BOBBY D. PRICE; GARY L. PASSON;
LANORA WORKMAN; JOHN DAVENPORT;
JIMMIE D. JENNINGS; LEO SCRUGGS;
DALLAS NIBLOCK; LEO SUGGS;
STANLEY W. MOORE; JOHN D. HORN;
ANTHONY SPITZLEY; MANUAL SENA;
JAMES F. AYRES; DANIEL A. SIKORSKY;
ALBERT E. OYOS; C.D. RIDGLEY;
EARL GREENE; SALVADOR C. PEREZ;
CESAR B. SHEEN; JOE MANUEL;
BENJAMIN SAENZ; ARTURO C. MARQUEZ;
EDWARD LAVELLE; ROBERT ROGNON;
BERNARDO SAENZ; PROTACIO S. ABREGO;
STEVEN MOYLAN; CARL M. LAVENDER;
RUBEN D. COTA; MANUEL F. GAMEZ;
NARCIZO REAZA; FRANK M. HERNANDEZ;
RONALD MURDOCK; JESSE TERRAZAS;
JIMMIE RODRIGUEZ; MANUEL R. BARRERA;
HOWARD WING; ROBERT R. CONTRERAS;
JOE C. NIXON; OSCAR J. MUNOZ;
THERESA A. WRIGHT; DORA PERKINS;
W.H. HOHENSEE; W.R. GUNN;
BOB KWNNIXURR; KENNETH D. WILLIAMS;
JAVIER ADAME, MANUEL M. HOLQUIN;
HARRY HILL; RICK SKINNER;
HAROLD MITCHELL; VINCE WOLPOFF;
WARREN YODER; WILLIAM SALINAS;
JOHN D. LENT; CARL CHRISTENSEN;
J.M. FEREZ; LISARDO JARAMILLO;
HENRY L. HOSKISON; BILL BASS;
BOB ROGNON; FRED WALLING;
HECTOR R. MENDOZA; MARTIN BAUTISTA;
DANIEL A. MERKLE; ROGER A. PETERSON;
JACK L. BYNUM; JOEL E. HENDERSON, SR.;
MARVIN L. WRIGHT; C.R. BLADES;
ROLANDO L. GALINDO;

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&
88-1750

ESEQUIEL BARCENA;
FLOYD L. BIDDLECOME, SR.,
RAMON A. RODRIGUEZ; RUBEN WILLIAMS;
ALVA J. CHANEY, JR.; CEASAR VAL VERDE;
GILBERT HERNANDEZ; VICTOR JUAREZ;
JOHN L. WASHINGTON; DAVID L. CARNEY;
THOMAS JARANILLE; JAMES D. WESTON;
RONALD R. MURDOCK; TONY C. GONZALES;
RICHARD A. SANCHEZ;
SHIRLEY F. BENNETT; BOBBY DERRING;
FULTON MARKS, JR.; ADOLFO ELIAS, JR.;
D. PATRICK WRIGHT;
NORMAN E. CARDWELL;
ROBERT M. FERGUSON; DON R. WHEELER;
J. BRANNON; ROBERT A. WESLEY;
ALVIN D. FITZGERALD; JAMES E. ROWE;
ALFRED M. MARTINEZ;
BERRY R. RAYMONDO; CARROLL C. ABEL;
OSCAR G. POWELL, JR.; ALVIN W. GREEN;
HUEY A. FREDEIU; BEN SAENZ;
HAROLD R. DAGNE;
BRITT INGRID KEITH; ROBERT M. TURNER,
Plaintiffs-Appellants-Cross-Appellees,

v.

COMMERCIAL LOVELACE MOTOR FREIGHT, INC., also known as C.L. Motor Freight, doing business as Lee Way Motor Freight, Inc.;
M.T. ALCOX; W.D. PERSAVICH;
C.C. MCCRACKEN; N.L. INGRUM; H.J. HILL;
G.W. MCINTYRE; TRANSPORTATION EQUIPMENT SERVICES, INC. and their directors;

EDWARD L. MULCAHY; PHILLIP WHITE;
H. F. POSTON,

Defendants-Appellees,

and

PEPSICO, INC., doing business as Lee Way Motor Freight, Inc., a Delaware corporation, individually;

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S. E. SCHRODER; JAMES ENGLISH;
LAWRENCE F. DICKIE;
JUDY NORMAN-DAVIS;
RICHARD CAMPBELL,

Defendants-Appellees-Cross-Appellants.

Nos. 88-1253
&
88-1750

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA
(D.C. No. 84-2807-P)

Joseph C. Long, Norman, Oklahoma (E. W. Keller and Trent Keller, Keller, Fernald & Keller, Oklahoma City, Oklahoma, with him on the brief), for plaintiffs-appellants.

Harold H. Reader, II, Cleveland, Ohio, and Michael L. Brody, Schiff, Hardin & Waite, Chicago, Illinois (John R. Couch, James E. Golden, Jr., with them on the brief), for defendants-appellees M. T. Alcox, W. D. Persavich, C. C. McCracken, V. L. Ingrum, H. L. Hill, and G. W. McIntyre.

Charles C. Green, Oklahoma City, Oklahoma, Roger Pascal, Michael L. Brody, Robert D. Campbell, Schiff Hardin & Waite, Chicago, Illinois, for defendants-appellees and cross-appellants PepsiCo, Inc., Lawrence Dickie, James English, Judy Norman-Davis, Richard Campbell, and Sharon Schroder.

Before McKAY, SEYMOUR, Circuit Judges, and KANE,** District Judge.

**Honorable John L. Kane, Senior District Judge, United States District Court for the District of Colorado, sitting by designation.

KANE, Senior District Judge.

This appeal arises out of an action brought by more than four hundred former employees of Lee Way Motor Freight, Inc.

against their former employer and others alleging violations of federal and Oklahoma securities law and common law fraud. After a segmented trial to the court on the issue of whether an interest in the instrument at issue, an employee stock ownership plan, constituted a security under federal law, the district court held that it did not and entered judgment for defendants on the federal securities claims. Finding no basis for federal jurisdiction over the plaintiffs' remaining state law claims, the court dismissed them in their entirety. This appeal and cross-appeal followed upon the court's denial of defendants' motion for costs and fees. We affirm in part and reverse in part.

Background

The following facts are undisputed unless otherwise noted: Plaintiffs-appellants in this matter are 485 former union employees of Lee Way Motor Freight, Inc. (Lee Way), a common carrier engaged in the interstate and intrastate transportation of commodities. In 1976, Lee Way was acquired by defendant-appellee Pepsico, Inc., which operated the company as a wholly owned subsidiary until June 1984 when it agreed to sell Lee Way to defendant-appellee Commercial Lovelace Motor Freight, Inc. (CL). Because CL was also a common carrier, this sale was not finalized until the Interstate Commerce Commission (ICC) approved the transaction in August 1984. CL operated Lee Way pursuant to a management agreement with Pepsico pending ICC approval of the sale.

Shortly after taking over Lee Way's operations, CL began soliciting Lee Way employees to participate in a Wage Reduction Program (Program) that had been in place at CL since 1983. This Program, which was optional for plaintiffs and Lee Way's other union employees,[1] provided each participating union employee

[1]Participation in the Program was a mandatory condition of employment for Lee Way's nonunion, salaried employees.

with an interest both in CL's existing company-administered employee stock ownership plan (CL ESOP) and a profit-sharing plan in return for the individual employee's agreement to a 17.35% reduction in the wages due him or her under the union's collective bargaining agreement. CL represented to Lee Way employees that the company would probably fail if they did not enroll in the Program. All of the plaintiffs in this action individually elected to participate in the Program. Less than a year later, CL merged with Lee Way and filed for bankruptcy. Lee Way's former assets were then allegedly reacquired by Pepsico.

In this action, plaintiffs allege that Pepsico's sale of Lee Way to CL and its subsequent reacquisition of Lee Way's assets upon CL's rapid demise were all part of a sham transaction designed to disguise Pepsico's intended and ultimately successful liquidation of Lee Way. Plaintiffs further allege that certain aspects of this sham transaction, including CL's solicitation of them to accept a wage reduction in return for an interest in the CL ESOP, violated federal and Oklahoma securities laws and constituted common law fraud. Plaintiffs seek various relief from defendants CL, Pepsico and officers and directors of both companies for these alleged transgressions, including, among other things, revocation of the plaintiffs' participation in the CL ESOP and recovery of more than $6 million in wages lost by plaintiffs as a result of their participation in the Wage Reduction Program.[2] Plaintiffs do not seek to recover benefits from the CL ESOP or otherwise enforce their rights as ESOP participants.

In their federal securities claim, plaintiffs allege that their interests in the CL ESOP were "investment contracts" subject to federal securities regulation pursuant to section 2(1) of the Securities Act of 1933 (1933 Act), 15 U.S.C. §§ 77b(1) (1988) (defining "security" to include "investment contracts"), and section

[2]Plaintiffs also seek $65 million from the defendants for fraud in the loss of their jobs and conversion of credit union and insurance deductions and $120 million in exemplary damages. Doc. 111 (Second Amended Complaint) at 49.

3(a)(10) of the Securities Exchange Act of 1934 (1934 Act), 15 U.S.C. § 78c(a)(10) (1988) (same). Plaintiffs further allege that CL's solicitation of Lee Way employees to accept an interest in the CL ESOP as part of the Wage Reduction Program constituted a sale of an unregistered security and securities fraud in violation of Sections 5 and 17(A) of the 1933 Act, 15 U.S.C. §§ 77e, 77q(a), and Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b).

The defendants filed various motions to dismiss and for summary judgment challenging plaintiffs' threshold assertion that their ESOP interests were investment contracts subject to protection under the 1933 and 1934 Acts (collectively "Securities Acts"). The district court denied these motions, but did hold that in order to prove that their interests in the CL ESOP were investment contracts, plaintiffs would have to demonstrate that the ESOP was "a voluntary contributory [employee benefit] plan [that] otherwise fit within the definition of a security." *Hupp v. Commercial Lovelace Motor Freight*, No. CIV-84-2807-A (W.D. Okla. Aug. 1, 1986) (1986 Order). The district court then ordered a segmented trial "limited to the factual issues as to whether the ESOP is a security" under this legal standard. *Id.*

Following a bench trial on this issue in December 1987, the district court ruled that plaintiffs' ESOP interests were not investment contracts and hence not securities under federal law. *Uselton v. Commercial Lovelace Motor Freight. Inc.*, CIV-84-2807-P (W.D. Okla. Jan. 29, 1988) (1988 Order). In reaching this result, the district court relied on its finding that the CL ESOP was a compulsory, noncontributory employee benefit plan and on the Supreme Court's holding in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), that such plans do not qualify as investment contracts under the three-part test first enunciated by the Court in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946). 1988 Order at 14. The district court then entered judgment against plaintiffs' federal securities claims and dismissed

their state law claims for lack of jurisdiction. Plaintiffs timely appealed this judgment. The Pepsico defendants[3] cross-appealed the district court's denial of their post-trial motion for costs and fees.

The parties have stipulated that the CL ESOP is an employee benefit plan that CL created and funded in March 1983 by issuing 4,001,000 shares (just more than fifty percent) of its common stock to the Central National Bank of Cleveland, Ohio, as Trustee for the plan. In return, CL received five promissory notes (Trust Notes) from the Trustee, each in the amount of $150,000, which were to mature serially from 1984 to 1988. Initially, CL held all of the plan's CL stock in pledge as security for the Trust Notes. As each Trust Note matured, however, the CL ESOP agreement required CL either to forgive the Trust Note then maturing or to make a cash contribution to the CL ESOP in the amount of the Trust Note so that the Trustee could pay off the Trust Note by redelivering the funds to CL. Once the annual Trust Note was paid by either of these methods, the ESOP agreement required CL to release 800,000 shares of the pledged stock to the ESOP to be allocated to the individual accounts of ESOP participants according to a formula stated in the ESOP agreement. This allocation formula was based on the ratio of each participant's compensation for a given year to the total compensation of all participants for that year. In the two years the CL ESOP operated, 1,600,000 CL shares were released to the ESOP and allocated to ESOP participants through these procedures. Under the terms of the ESOP, these allocations vested immediately with the ESOP participants.

All shares allocated to participating employees through the ESOP were derived from those initially issued to the Trust. No proceeds from the Program's wage reduction requirement were used to purchase CL stock or to otherwise fund the CL ESOP,

[3]The Pepsico defendants are Pepsico, Inc., S.E. Schroder, James English, Lawrence Dickie, Judy Norman-Davis and Richard Campbell.

no CL shares were ever purchased by the Trustee on the open market and no CL shares other than those initially issued by CL to the Trustee were ever acquired by the Trust. The CL ESOP agreement also prohibited participants from making direct monetary contributions to the CL ESOP and no such employee contributions were ever made. As an employee benefit plan, the CL ESOP was subject to regulation under the Employment Securities Income Retirement Program (ERISA), 29 U.S.C. §§ 1001-1461 (1988).

Discussion

The principal issue in this appeal and cross-appeal is whether the district court was correct in holding that plaintiffs' interests in the CL ESOP were not investment contracts and hence not "securities" subject to the protections of the Securities Acts. Other issues on appeal concern the district court's dismissal of plaintiffs' Oklahoma securities claims, several of the court's evidentiary rulings and its denial of the Pepsico defendants' motion for costs and fees. We address each of these issues in turn.

A. Federal Securities Issue

The plaintiffs contend that the district court erred as a matter of law in holding that their interests in the CL ESOP were not investment contracts and hence not securities within the purview of the Securities Acts. We address this question in two steps. First, we consider the district court's holding that these ESOP interests are not investment contracts under the standards stated by the Supreme Court in *Howey* and *Daniel*. Following our conclusion that plaintiffs' ESOP interests are securities under these standards, we proceed to a legal question not reached by the district court, which is whether these interests are nonetheless outside the reach of the Securities Acts due to their regulation under ERISA.

In addressing these issues, we consider questions of law *de novo*, while reviewing the district court's decision on questions of fact under the clearly erroneous standard. *Las Vegas Ice & Cold Storage Co. v. Far West Bank*, 893 F.2d 1182, 1185 (10th Cir. 1990). On the mixed question of whether the facts satisfy the proper legal standard, we conduct a *de novo* review if the question primarily involves the consideration of legal principles and apply the clearly erroneous standard if the question is primarily a factual inquiry. *Love Box Co. v. Commissioner*, 842 F.2d 1213, 1215 (10th Cir.), *cert. denied*, 488 U.S. 820 (1988).

1. Whether the plaintiffs' interests in the CL ESOP were investment contracts

Plaintiffs contend that their interests in the CL ESOP qualify as securities under the Securities Acts because they are investment contracts. Under the Supreme Court's seminal decision in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), the test to determine whether a financial relationship constitutes an investment contract is "whether the scheme involves [1] an investment of money [2] in a common enterprise [3] with profits to come solely from the efforts of others." *Id.* at 301; *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975); *Banghart v. Hollywood Gen. Partnership*, 902 F.2d 805, 807 (10th Cir. 1990). In applying this test, "the economic realities of the transaction—rather than the names that may have been employed by the parties," are determinative. *Forman*, 421 U.S. at 851-52.

The Supreme Court has had one opportunity since *Howey* to consider whether an employee benefit plan is an investment contract and hence a security under the Securities Acts. In that case, *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), the question presented was whether a participant in a company pension plan could invoke the Securities Acts as part of an effort to recover benefits under the plan. *See id.* at 553, 555-56. The Court held that he could not because: (1) the participant's

interest in the pension plan failed the *Howey* test for an investment contract; (2) there was no congressional or administrative record of such plans being subject to federal securities regulation and (3) ERISA already provided participants in such plans with the right to challenge benefit determinations. *See id.* at 558-70.

In applying the *Howey* test to the plaintiff's pension plan interest, the Court first identified the plan in question as a compulsory, noncontributory defined benefit plan. *Id.* at 553, 554 n.3. This description indicates that the plaintiff, as an employee of his company, had no option but to participate in the plan, that he made no cash or other type of contribution specifically to the plan, *see id.*, and that the benefits he expected to receive from the plan were fixed without reference to the success or failure of the plan's investments. *See Cunha v. Ward Foods, Inc.*, 545 F. Supp. 94, 99 nn.3-5 (D. Haw. 1982), *aff'd in part and rev'd in part on other grounds*, 804 F.2d 1418 (9th Cir. 1986); *O'Neil v. Marriott Corp.*, 538 F. Supp. 1026, 1030 (D. Md. 1982) (defining a voluntary plan); *Tanuggi v. Grolier, Inc.*, 471 F. Supp. 1209, 1213 n.3 (S.D.N.Y. 1979) (defined benefit plan).

The Court determined that the plaintiff's interest in this type of employee benefit plan failed both the first and third prongs of the *Howey* test. The Court found that it failed *Howey*'s initial "investment of money" requirement because the plan's noncontributory structure precluded the plaintiff from making the requisite investment at the same time that its involuntary component prevented him from making an affirmative investment decision "to give up a specific consideration in return for a separable financial interest with the characteristics of a security." *Daniel*, 439 U.S. at 559. The Court also considered and rejected plaintiff's alternate contention that his labor provided the necessary "investment" in the pension plan, concluding instead that the plan was "a relatively insignificant part of [the plaintiff's] total and indivisible compensation package" so that "[h]is decision to accept and retain covered employment may have only an attenuated relation-

ship, if any, to perceived investment possibilities of a future pension." *Id.* at 560. As to *Howey*'s final requirement, the Court held that the plaintiff's expected profits from his company's defined benefit plan were not dependent on entrepreneurial or managerial efforts of others, as required by *Howey,* because the plan's income consisted primarily of continuing employer contributions, "a source in no way dependent on the efforts of the [plan's] managers." *Id.* at 562. In addition, the Court noted that the plan at issue required participants to meet "substantial" preconditions before their interests in the plan and hence in the plan benefits vested. *Id.* As a result, the Court found that even if the plan benefits were considered profit on some investment by the employee, "this profit would depend primarily on the employee's effort to meet the vesting requirements, rather than the [plan's] investment success." *Id.* (footnote omitted).

Since the *Daniel* decision, both this court and others have considered whether various types of employee benefits plans qualify as investment contracts under the *Howey* test. *See, e.g., Salazar v. Sandia Corp.*, 656 F.2d 578, 581-82 (10th Cir. 1981) (compulsory, noncontributory pension plan); *Black v. Payne*, 591 F.2d 83, 87-88 (9th Cir.) (compulsory, contributory employee benefit plan), *cert. denied*, 444 U.S. 867 (1979); *Cunha*, 545 F. Supp. at 99-101 (voluntary, contributory plan). The consensus from these decisions is that an employee benefit plan that is either noncontributory or compulsory is not an investment contract because it does not allow a participant to make the "investment" required by the first prong of the *Howey* test. *See, e.g., Salazar,* 656 F.2d at 582. The SEC concurs in this view. Employee Benefit Plans, Securities Act Release No. 33-6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1051 at 2073-8 to 2073-9 (Feb. 1, 1980) [hereinafter "SEC Release No. 33-6188]; Employee Benefit Plans, Securities Act Release No. 33-6281, 1 Fed. Sec. L. Rep. (CCH) ¶ 1052 at 2073-31 (Jan. 15, 1981) [hereinafter "SEC Release No. 33-6281]. A number of courts have also held that certain voluntary, contributory em-

ployee benefit plans are not investment contracts, but only because specific aspects of each plan caused it to fail *Howey*'s final requirement that the profits or benefits from the plan result from the efforts of others. *See, e.g., Coward v. Colgate-Palmolive Co.*, 686 F.2d 1230, 1236-37 (7th Cir. 1982), *cert. denied*, 460 U.S. 1070 (1983); *Cunha*, 545 F. Supp. at 99-100; *O'Neil*, 538 F. Supp. at 1031; *Tanuggi*, 471 F. Supp. at 1214, 1216; *Newkirk v. General Elec. Co.*, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,216 (N.D. Cal. Aug. 31, 1979).

In this case, the district court held that plaintiffs' interests in the CL ESOP were not investment contracts because the ESOP was neither contributory nor voluntary and thus failed *Howey*'s "investment" requirement. 1988 Order at 14. The plaintiffs argue on appeal that both of these findings are incorrect as a matter of law, that their interests in the CL ESOP were in fact both voluntary and contributory and hence meet the first prong of the *Howey* test and that the ESOP otherwise satisfies *Howey*'s requirements for establishing the existence of an investment contract. We agree with plaintiffs on each of these points.

The district court held that the CL ESOP was noncontributory because Lee Way employees made no monetary contributions to the plan through wage deductions or other means. 1988 Order at 14. This finding reflected the court's legal conclusion that an employee benefit plan must fit within the following definition of "contributory" in order to satisfy *Howey*'s initial "investment of money" requirement:

> 2. "Contributory" plan means that the workers must be making payments into and enhancing the ESOP corpus, although these payments may be accomplished through some accounting system set up by the employer, the ESOP Trust or otherwise.
>
> 3. Neither lump sum [n]or periodic payments on behalf of the workers made by others will suffice for a contributory plan.

> 4. A mere showing that the employer obtained relief from its overhead obligation for wages, creating a savings from which it paid down the ESOP note, will not suffice.

1986 Order at 1-2.

This is an incorrect statement of *Howey*'s "investment" requirement for two reasons. First, the district court's definition of "contributory" assumes that only direct monetary contributions will satisfy the requirement. In fact, and in spite of *Howey*'s reference to an "investment of money," it is well established that cash is not the only form of contribution or investment that will create an investment contract. Instead, the "investment" may take the form of "goods and services," *Daniel*, 439 U.S. at 560 n.12, or some other "exchange of value." *Hocking v. Dubois*, 885 F.2d 1449, 1471 (9th Cir. 1989), *cert. denied*, 110 S. Ct. 1805 (1990); *see Yoder v. Orthomolecular Nutrition Inst., Inc.*, 751 F.2d 555, 560-61 (2d Cir. 1985) (stating that a person who commits herself to employment in return for the promise of stock in her employer's company makes the necessary investment in her company's securities to form an investment contract); *Dubin v. E.F. Hutton Group, Inc.*, 695 F. Supp. 138, 145-44 (S.D.N.Y. 1988) (holding that plaintiff's acceptance of employment based in part on the value of a promised interest in his employer's equity ownership plan resulted in the sale of a security). Thus, the fact that the terms of the CL ESOP did not permit employees to make direct monetary contributions to it is not determinative of whether Lee Way's union employees invested in or contributed to the CL ESOP as required by the first prong of the *Howey* test.

The legal standard employed by the district court also errs in focusing solely on the terms of the CL ESOP to determine whether plaintiffs contributed to the plan. The proper inquiry was whether the economic realities of the transaction as a whole demonstrated an investment or "an exchange of value" by the plaintiffs. *See Forman*, 421 U.S. at 849, 851; *Hocking*, 885 F.2d at 1471. Here, it is undisputed that the transaction in question,

plaintiffs' election to participate in CL's Wage Reduction Program, required plaintiffs and Lee Way's other union employees to surrender a portion of the wages due them under a valid collective bargaining agreement in exchange for an interest in the CL ESOP and the profit-sharing plan. The economic reality of the transaction, therefore, was that plaintiffs contributed their legal right to a portion of their wages to CL in return for the right to acquire CL stock via the CL ESOP and to participate in CL's profit-sharing plan. At least two courts have held that employee contributions of this sort constitute sufficient tangible and definable consideration to serve as an "investment" or "contribution" to an employee benefit plan for purposes of the *Howey* test. *See Hood v. Smith's Transfer Corp.*, 762 F. Supp. 1274, (W.D. Ky. 1991); *Harris v. Republic Airlines, Inc.*, [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,772 at 98,625-26 (D.D.C. May 18, 1988). We agree with this conclusion and accordingly hold, under the proper legal standard and the undisputed facts of this case, that plaintiffs' interests in the CL ESOP were contributory as a matter of law.

We also conclude as a matter of law that the district court erred in holding that plaintiffs' participation in the CL ESOP was involuntary and thus precluded them from having any investment motive in joining the plan. *See* 1988 Order at 14. The district court based this conclusion on its factual finding that plaintiffs felt they had no choice but to join the Wage Reduction Program if they wanted to save Lee Way and their jobs. *Id.* at 13, 14. We have several difficulties with holding the CL ESOP to be an involuntary plan on this basis. First, the established definition of a voluntary plan is simply a plan that permits employees to elect whether or not to participate. *See Salazar*, 656 F.2d at 581; *Cunha*, 545 F. Supp. at 99 n.4; *O'Neil*, 538 F. Supp. at 1030; SEC Release No. 33-6188 at 2073-6 n.19. This definition is consistent with the Supreme Court's statement in *Daniel* that an investor is someone who "chose to give up a specific consideration in return

for a separable financial interest with the characteristics of a security." *Daniel*, 439 U.S. at 559. Applying this legal standard to this case, there is no question that participation in the CL ESOP was in fact voluntary for Lee Way's union employees because each such employee had the option of either accepting CL's Wage Reduction Program or of continuing employment under the terms of the existing union contract. There is also no question that each union employee who joined the CL ESOP gave up specific consideration, *i.e.*, a portion of his or her wages, in return for a separable financial interest in the CL ESOP. Each employee's interest in the CL ESOP, moreover, translates into an interest in CL stock, an interest having all of the characteristics of a security.[4] No more than this is required to prove that Lee Way's union employees were investors making an investment decision when they individually agreed to give up a portion of their wages in return for an interest in the CL ESOP. *See id.*[5]

We also disagree with the district court's legal conclusion that the plaintiffs' desire to save Lee Way and their jobs negated their otherwise voluntary decision to invest in the CL ESOP through the Wage Reduction Program. In fact, the "save the company, save our jobs" motive identified by the district court is consistent with a traditional investment motive because each is concerned

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[4]Several courts have found that this fact alone is sufficient to establish that an ESOP interest is stock and hence is a security without reference to *Howey*'s test for the existence of an investment contract. *See Harris*, [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,772 at 98,623; *Hood*, 762 F. Supp. at ; *Foltz v. U.S. News & World Report, Inc.*, 627 F. Supp. 1143, 1159 (D.D.C. 1986). Because plaintiffs have not pleaded or argued that their ESOP interests might be a security under this alternate theory, we do not address it.

[5]This determination is also consistent with the SEC's conclusion that "[a]n employee who is given a choice whether to participate in a voluntary pension plan, and decides to contribute a portion of his earnings or savings to such plan, has clearly made an investment decision, particularly when his contribution is invested in securities issued by his employer." SEC Release No. 33-6188 at 2073-10.

with and makes an investment in the future of the company.[6] Thus, we find no basis for the district court's holding that this motive made plaintiffs' participation in the CL ESOP involuntary or otherwise prevented them from acting as investors when they elected to participate in the CL ESOP. *See Hood*, 762 F. Supp. at

(holding that employees' participation in ESOP was voluntary even though employer represented to employees that company's survival depended on employees' acceptance of wage reduction/ESOP package).[7]

Because the CL ESOP was a voluntary, contributory employee benefit plan for Lee Way's union employees, their interests in the ESOP resulted from their "investment" in the ESOP, thus satisfying the first prong of *Howey*'s test for an investment contract. *See Cunha*, 545 F. Supp. at 99-100. The question remains, however, whether these interests also satisfy *Howey*'s final two requirements that these interests concern "a common enterprise" in which profits "come solely from the efforts of others." *Howey*, 328 U.S. at 301. The district court did not reach this question because it found *Howey*'s initial investment requirement to be dispositive.

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[6]CL itself recognized the close link between these concepts when it stated in its Lee Way solicitation materials that "a principal purpose for instituting the [Wage Reduction] Program is to provide a possibility for a return of the companies['] profitability and to provide employees with a share of any such profits." Defendants' Ex. 20, Subex. D at 2.

[7]The district court's holding that the CL ESOP was an involuntary plan and hence not an investment contract because of the plaintiffs' desire to save their jobs is also troubling because it essentially permits employers to avoid regulation under the Securities Acts (assuming the ESOP interest would otherwise meet the *Howey* test) simply by persuading employees that they must contribute to the ESOP if they want to preserve the company and their jobs. The employees, however, may not have sufficient information available to them to test their employer's representations concerning the company's financial condition. It seems particularly inappropriate, therefore, to determine whether the employees' interest is a security subject to the protective disclosure and antifraud provisions of the Securities Acts on the basis of the employees' acceptance of these representations.

Upon review of the record, we hold that the plaintiffs' ESOP interests satisfy both of these requirements as a matter of law. There is no dispute that the CL ESOP qualifies as a common enterprise and thus satisfies the second prong of the *Howey* test. *See Childers v. Northwest Airlines, Inc.*, 688 F. Supp. 1357, 1363 (D. Minn. 1988); *Harris*, [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,772 at 98,624. *Howey*'s final requirement is met if the enterprise can reasonably be expected to produce profits in the form of capital appreciation or participation in earnings resulting from the investment, *Forman*, 421 U.S. at 852, and the success or failure of the enterprise is significantly affected by the managerial or entrepreneurial efforts of persons other than the investor.[8] *See Banghart*, 902 F.2d at 807; *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 463 (9th Cir. 1985). Both of these requirements are met in this case because any profit on plaintiffs' ESOP interest would occur through dividend distributions and appreciation in the value of the stock allocated to their accounts, which in both cases would result primarily from the efforts CL's managers and its employees. Thus, "[e]ach employee that invested in the [Wage Reduction Program] was dependent on the efforts of others to realize any benefits from his or her investment decision." *Harris*, [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,772 at 98,624. This fact distinguishes the CL ESOP from other voluntary, contributory employee benefit plans that have failed this final prong of the *Howey* test. *See, e.g.*, *Coward*, 686 F.2d at 1236-37; *Cunha*, 545 F. Supp. at 99-100;[9] *O'Neil*, 538 F. Supp. at 1031; *Tanuggi*, 471 F. Supp. at 1214, 1216; *Newkirk*,

[8]As this language suggests, *Howey*'s requirement that profits "come solely from the efforts of others" is not read literally to prevent formation of an investment contract when the investor contributes some effort to the enterprise. *See, e.g., Meyer v. Dans un Jardin, S.A.*, 816 F.2d 533, 535 (10th Cir. 1987); *SEC v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 584 (2d Cir.), *cert. denied*, 459 U.S. 1086 (1982).

[9]The district court's reliance on *Cunha*, *see* 1988 Order at 14, is misplaced for this reason.

[1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,216.[10] Accordingly, plaintiffs' interests in the CL ESOP satisfy this final *Howey* requirement. Having previously concluded that plaintiffs' interests in the CL ESOP satisfy *Howey*'s other requirements for establishment of an investment contract, we therefore hold that these interests were investment contracts and hence securities under the Securities Acts.

The defendants contend that the Supreme Court's *Daniel* decision requires a different result and supports the district court's decision that plaintiffs' interests in the CL ESOP are not securities. In making this argument, they focus on the Court's rejection of the employee's assertion that the labor he provided his employer constituted an "investment" in the employer's compulsory, noncontributory pension plan. The Court rejected this argument because:

> In a pension plan such as this one, . . . the purported investment is a relatively insignificant part of an employee's

[10]Most of these cases concerned defined benefit plans that pay fixed or determinable benefits based on factors such as the age at which a participant retires, *see* SEC Release No. 33-6118 at 2073-7, rather than defined contribution plans, such as the CL ESOP, that provide varying benefits based on factors such as the amount of plan contributions and the plan's investment success. *See, e.g., Coward,* 686 F.2d at 1236-37; *Cunha,* 545 F. Supp. at 99-100; *Tanuggi,* 471 F. Supp. at 1214, 1216. The only two courts that appear to have considered whether employee interests in a voluntary, contributory defined contribution plan might satisfy the *Howey* test held that they did not because of plan characteristics that are not present here. *See O'Neil,* 538 F. Supp. at 1031 (in a "close question," no security found to exist because (1) plan's staggered vesting requirements made benefits dependent on length of service, (2) significant plan profits derived from other employees withdrawing from the plan before becoming fully vested, (3) amount of earnings on employee contributions was capped and (4) amount of benefits was significantly dependent on amount of employer, rather than employee, contribution); *Newkirk,* [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,216 (apparently holding plan interests were not securities because majority of plan's income was derived solely from employer contributions and amount of benefits was dependent on employees' success in meeting vesting requirements).

> total and indivisible compensation package. . . . Only in the most abstract sense may it be said that an employee "exchanges" some portion of his labor in return for these possible benefits. He surrenders his labor as a whole, and in return receives a compensation package that is substantially devoid of aspects resembling a security. His decision to accept and retain covered employment may have only an attenuated relationship, if any, to perceived investment possibilities of a future pension. Looking at the economic realities, it seems clear that an employee is selling his labor primarily to obtain a livelihood, not making an investment.

Daniel, 439 U.S. at 560 (footnote omitted). Similarly, defendants argue, the economic reality of this transaction is that plaintiffs sold their labor to CL in order to obtain a compensation package that only incidentally included participation in the CL ESOP.

The difficulty with this argument is that it ignores that Lee Way's union employees did more than merely contribute labor to obtain an interest in the CL ESOP. Instead, each deliberately chose to surrender his or her right to a percentage of a preexisting compensation package in return for an ESOP interest. Thus, each contributed specific consideration for his interest, rather than merely exchanging labor for an indivisible compensation plan that incidentally provided for participation in a pension plan. The Supreme Court's holding that no investment contract existed with respect to the employee benefit plan and transaction before it in *Daniel* is not, therefore, determinative of this same question presented in the context of the very different plan and transaction at issue in this case.[11] For the reasons set out in our discussion of

[11]The *Daniel* Court's holding regarding the third *Howey* requirement, concerning profit from the efforts of others, is also inapplicable here due to the differences between the CL ESOP and the pension plan at issue in *Daniel*. In *Daniel*, the pension fund's "income" consisted almost entirely of employer contributions, rather than profits generated by the efforts of the fund managers, and the employee's expectation of profits, if any, depended primarily on his or her success in meeting the plan's

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the *Howey* test, we also conclude that our decision that plaintiffs' voluntary, contributory participation in the CL ESOP created an investment contract under *Howey's* three-part test is fully consistent with the Supreme Court's statement and application of that test in *Daniel*.[12]

Our decision that the CL ESOP is an investment contract is also consistent with *Daniel* for another reason. In that case, the Supreme Court concluded that plaintiff's pension plan interest was not a security in part because there was no administrative or congressional record interests in such plans being subject to regulation under the Securities Acts. *See id.* at 563-69. As the *Daniel*

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vesting requirements, rather than on the fund's investment success. 439 U.S. at 561-62. In this case, in contrast, the plaintiffs' right to the stock they received via the CL ESOP vested immediately and any profits they received on their ESOP investment were directly attributable to the efforts of CL and its managers.

[12]Defendants also cite *In re Crippin*, 877 F.2d 594 (7th Cir. 1989), *Childers v. Northwest Airlines, Inc.*, 688 F. Supp. 1357 (D. Minn. 1988) and *Bauman v. Bish*, 571 F. Supp. 1054 (N.D. W. Va. 1983) for the proposition that an employee's acceptance of a wage reduction in return for participation in an ESOP is an employment/compensation agreement rather than an investment in a security. Each of these cases is distinguishable. In both *Bauman* and *Childers*, the district courts held that an employee's acceptance of a wage reduction as part of a modified, union-approved compensation package that included participation in an ESOP did not constitute "value" sufficient to establish the "sale" of an ESOP interest under the Securities Acts. *See Childers*, 688 F. Supp. at 1363; *Bauman*, 571 F. Supp. at 1064. These cases are thus distinguishable in that employee-participants in these plans did not make individual investment decisions and in the court's examination of their investment in the context of determining whether a sale occurred rather than whether a security existed in the first instance. *See id. In re Crippin* is even more readily distinguishable because it considered the effect of an employee's wage-reduction-for-ESOP-interest exchange only for purposes of determining whether the exchange was an executory contract that could be rejected as part of an employee-participant's bankruptcy. 877 F.2d at 596-97. To the extent these cases are not distinguishable, we also simply disagree that plaintiffs' wage concessions in this case were not investments that led to the creation of investment contracts under *Howey*.

Court noted, however, this is not true as to voluntary, contributory employee benefit plans. *See id.* The SEC has long distinguished voluntary, contributory employee benefit plans from other types of benefit plans and maintained that such voluntary, contributory plans are "securities" for purposes of the Securities Acts.[13] This consistent and long-standing agency interpretation of the status of employee interests in voluntary, contributory employee benefit plans under the Securities Acts is entitled to considerable weight unless it violates the "clear meaning of [the] statute, as revealed by its language, purpose, and history." *Daniel*, 439 U.S. at 566 n.20; *see also United States v. National Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 719 (1975).

Congress has also long demonstrated its belief and implied intent that at least some employee benefit plans, and particularly

[13]The SEC first stated this position as early as 1941, Opinions of SEC Assistant General Counsel, [1941-44 Transfer Binder] Fed. Sec. L. Serv. (CCH) ¶ 75,195 (1941), *reprinted in* 1 Pens. Plan Guide (CCH) ¶ 1104.101 at 2404-05 (1986) (stating that certain voluntary contributory employee stock investment plans were investment contracts subject to federal securities regulation); *see* Hearings on Proposed Amendments to the Securities Act of 1933 and to the Securities Exchange Act of 1934 Before the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess. 894-97 (1941) (testimony of Commissioner Purcell), and reiterated this view in 1953 and 1962, *see* Letter to CCH from Assistant Director, Division of Corporation Finance, Securities Exchange Commission (May 12, 1953), 1 Pens. Plan Guide (CCH) ¶ 1104.102 at 2406 (1986); Letter to CCH from Chief Counsel, Division of Corporation Finance, Securities Exchange Commission (Aug. 1, 1962), 1 Pens. Plan Guide (CCH) ¶ 1104.103 at 2406 (1986), and again in 1979 in successful opposition to a proposal to amend ERISA and the Securities Acts to exclude interests in employee benefits plans from the Securities Acts' antifraud provisions. *See* Hearings on S. 209 Before the Senate Committee on Human Resources, 96th Cong., 1st Sess. 657-74 (1979) (statement of Harold M. Williams, Chairman, Securities and Exchange Commission). The SEC again expressed its view that employee interests in voluntary contributory employee benefit plans are securities in two releases issued after and in response to the Supreme Court's decision in *Daniel. See* SEC Release No. 33-6188 at 2073-9; SEC Release No. 33-6288 at 2073-31.

voluntary, contributory plans, are subject to federal securities regulation. In 1934, for example, it rejected an express attempt to exempt employee stock investment plans from the definition of securities under the Acts, basing this decision "on the ground that the participants in [such] plans may be in as great a need of the protection afforded by availability of information concerning the issuer for which they work as are most other members of the public." H.R. Conf. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934). In 1970, Congress also recognized by implication that some employee benefit plans were subject to the Securities Acts when it amended the 1933 Act to exempt certain employee benefit plans from the Act's registration requirements. *See* Pub. L. No. 91-547 (Dec. 14, 1970) and Pub. L. No. 91-567 (Dec. 22, 1970), *codified at* 1933 Securities Act, § 3(a)(2), 15 U.S.C. § 77c(a)(2). Congress' consideration and rejection of a bill that would have expressly exempted interests in all employee benefit plans from the antifraud provisions of the Securities Acts is also evidence that it considered at least some such interests to be otherwise subject to regulation under these Acts. *See* S.209, 96th Cong., 1st Sess. (Feb. 8, 1979). In a report analyzing the need to enact ERISA, the Senate focused on the plans subject to such regulation when it described its understanding that "[p]ension and profit-sharing plans are exempt from coverage under the Securities Act of 1933 . . . *unless the plan is a voluntary contributory pension plan* and invests in the securities of the employer company in an amount greater than that paid into the plan by the employer."[14] Interim Report of Activities of the Private Welfare and Pension Plan Study, 1971, S. Rep. No. 634, 92d Cong., 2d Sess. 96 (1972) (emphasis added). Thus, unlike the situation in *Daniel*, the administrative and congressional record regarding the employee

[14]The latter reference to the amount of the plan's investment in the employer's securities apparently relates to the requirements for establishing the plan's exemption from the Securities Act registration requirements under the 1970 amendment described above. *See* 15 U.S.C. § 77c(a)(2). It has no apparent relevance to the definition of employee benefit plans subject to the Securities Acts' antifraud provisions.

benefit plan at issue here, the voluntary, contributory CL ESOP, supports our decision that the plaintiffs' interests in this plan are securities.

2. The effect of alternate federal regulation of plaintiffs' ESOP interests under ERISA

Even if the district court erred in concluding that plaintiffs' interests in the CL ESOP were not investment contracts, its judgment that plaintiffs' ESOP interests fall outside the protection of the Securities Acts may nonetheless be affirmed if the "context" of these interests supports this result. 15 U.S.C. §§ 77b(1), 78c(a)(10) (defining an "investment contract" to be a federally protected "security" "unless the context otherwise requires"). In *Holloway v. Peat, Marwick, Mitchell & Co.*, 879 F.2d 772 (10th Cir. 1989) (*Holloway I*), we relied on this language as interpreted by the Supreme Court in *Marine Bank v. Weaver*, 455 U.S. 551, 557-59 (1982), and *Daniel*, 439 U.S. at 569-70, to hold that "[e]ven if the instruments [at issue] potentially qualify as securities because of the factual circumstances underlying the transactions, the context of other federal regulation may still remove these instruments from the federal securities laws." *Holloway I*, 879 F.2d at 783.[15] In this case, it is undisputed that the CL ESOP

[15]While this appeal was pending, the Supreme Court vacated the judgment in *Holloway I* and remanded the case for further consideration in light of *Reves v. Ernst & Young*, 494 U.S. 56 (1990). *See Peat Marwick Main & Co. v. Holloway*, 110 S. Ct. 1314 (1990). *Reves*, like *Holloway I*, concerned the circumstances under which an instrument categorized as a "note" will be considered a "security" within the meaning of the federal securities laws. *See Reves*, 110 S. Ct. at 948; *Holloway I*, 879 F.2d at 777. In *Reves*, the Court adopted a "family resemblance" test for determining when a note is a "security." *Reves*, 110 S. Ct. at 951. This test initially presumes that a note is a security, but provides that the presumption may be rebutted by reference to four factors, the last of which is "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." *Id.* at 951-52. In *Holloway I*, this court employed a similar test, but structured it in

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and plaintiffs' rights as participants in this ESOP are extensively regulated under ERISA, thus requiring us to determine whether this alternate federal regulation removes the plaintiffs' CL ESOP-investment contracts from the realm of federal securities laws.

The test under *Holloway I* for determining whether the existence and application of nonsecurities-related federal regulation bars application of the Securities Acts is whether "such alternate federal regulation accomplishes the same purposes as the securities laws, thereby making the securities laws' protections for investors duplicative and unnecessary." *Holloway I*, 879 F.2d at 778 (citing and construing *Marine Bank*, 455 U.S. at 557-59; *Daniel*, 439 U.S. at 569-70); *see also Holloway I*, 879 F.2d at 783-84, 786. As we described in *Holloway I*, the fundamental purpose of these laws is protection of the investor " 'from the sale of worthless securities through misrepresentation.' " *Id.* at 786 (quoting *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith,*

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two parts, with the first part looking solely at the "security" question, while the second, as described above, focused on the consequences of any alternate federal regulation. *See Holloway I,* 879 F.2d at 775-83, 783-88.

On remand of *Holloway I,* we reaffirmed our earlier judgment upon finding that our original analysis had adequately addressed the four *Reves* factors. *Holloway v. Peat, Marwick, Mitchell & Co.,* 900 F.2d 1485, 1487-88 (10th Cir.) (*Holloway II*), *cert. denied,* 111 S. Ct. 386 (1990). In so doing, we implicitly adopted our earlier analysis in *Holloway I. See id.* at 1488 & n.1. Because *Reves* contains no language undercutting the premise of *Holloway I*'s federal regulatory analysis, which is that the existence of alternate federal regulation will in some cases prevent an erstwhile security from being regulated under the Securities Acts, *see Holloway I,* 879 F.2d at 778, 783, we find that this analysis is still valid and may be relied upon in this case. *See Marine Bank,* 455 U.S. at 558-59 (federal bank regulations providing investors with abundant protection from fraud sufficient to prevent bank certificate of deposit from being subject to Securities Acts); *Daniel,* 439 U.S. at 569-70 (ERISA regulation of compulsory, noncontributory pension plan one factor in holding that plan was not a security).

Inc., 756 F.2d 230, 237 (2d Cir. 1985)). The Securities Acts achieve this purpose by two means: (1) requiring disclosure to investors of "relevant, accurate information upon which to base an investment decision" and (2) providing "meaningful remedies for investors when the antifraud provisions of the laws have been violated." *Id.* at 786. If alternate federal regulation "abundantly protects" the investor on both of these counts, then this regulation may displace application of the federal securities laws. *Id.* (citing *Marine Bank*, 455 U.S. at 558-59). The purpose behind at least the first of the Securities Acts' protective provisions may also be served if, "in lieu of full disclosure to investors of relevant, accurate information upon which to base an investment decision, investors are protected by another entity that acts on their behalf to monitor the issuing entity and to take corrective actions to protect their investments." *Id.*

Plaintiffs argue that ERISA does not displace application of the Securities Acts in this case for two reasons. First, they contend that ERISA does not provide the necessary "abundant protection" for their investment in the CL ESOP as required by *Holloway I*. Second, they argue that even if ERISA did provide such protection, this duplicate federal regulation does not prevent application of the Securities Act in this case because both Congress and the SEC have indicated that voluntary, contributory employee benefit plans, such as CL ESOP, are subject to federal securities regulation notwithstanding the existence of possibly duplicative ERISA regulation. The Pepsico defendants argue in turn that both of these arguments must fail, and that the district court's judgment must be affirmed, because the Supreme Court previously decided in *Daniel* that ERISA preempts application of the Securities Acts to all forms of employee benefit plans. Each of these arguments is discussed below.

a. Investor protection under ERISA

In *Holloway I*, we held that alternate federal regulation must fulfill both the disclosure and remedial purposes of the Securities

Acts before it will displace the protections offered by these Acts. 879 F.2d at 786. The first of these purposes is met if the alternate federal regulation either compels the disclosure of "relevant, accurate information upon which to base an investment decision" or allows the federal regulators to act on behalf of investors "to monitor the issuing entity and to take corrective actions to protect their investments." *Id.* In this case, defendants argue that the extensive disclosure and reporting requirements imposed on plan administrators under ERISA satisfy this requirement. As plaintiffs point out, however, all of these disclosure requirements apply only to individuals who are already participants or beneficiaries[16] of an ERISA-regulated benefit plan.[17] *See* 29 U.S.C. § 1021(a) (1988); 29 C.F.R. Part 2520, Subpart F (1990); *see Childers*, 688 F. Supp. at 1361 (ERISA disclosure provisions only extend to plan participants and beneficiaries). Thus, ERISA, unlike the Securities Acts, does not require plan administrators or promoters to provide any information about the plan to individuals who are considering whether to become plan participants. *See* 15 U.S.C. § 77e(b) (requiring issuer of security to provide prospectus to potential investor unless security is exempt from registration).

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[16]ERISA defines a "participant" as "any employee or former employee of an employer . . . who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization or whose beneficiaries may be eligible to receive any such benefit." 29 U.S.C. § 1002(7). For an individual to be a "participant" under the "may become eligible" portion of this definition, the individual "must have a colorable claim that (1) he or she will prevail in a suit for benefits, or that (2) eligibility requirements will be fulfilled in the future." *Firestone Tire & Rubber Co. v. Bruch,* 109 S. Ct. 948, 958 (1989). ERISA defines a "beneficiary" as "a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder." 29 U.S.C. § 1002(8).

[17]This point is emphasized by the fact that ERISA only requires a plan administrator to provide plan information to new plan participants within 90 days *after* the individual joins the plan. 29 U.S.C. § 1024(b).

The focus of ERISA's disclosure requirements, moreover, is on informing plan participants of their rights and obligations under the plan, and not on distributing information regarding the plan's financing or its financial soundness. *See* 29 U.S.C. § 1022(b) (only financial information required to be disclosed to participants under ERISA is "the source of financing of the plan and the identity of any organization through which benefits are provided"); 29 C.F.R. § 2520.102-3(q) (same). Although detailed financial information, such as that subject to disclosure under the Securities Acts, *see* 15 U.S.C. §§ 77e, g, 77aa (Schedule A),[18] is available to an ERISA plan participant upon request, *see* 29 U.S.C. § 1024(b)(2), (4) (plan administrator must provide participants with plan's annual report upon request); *id.* at § 1023 (requiring annual report to include detailed financial information), it is not automatically provided to plan participants or available at all to prospective participants. Accordingly, ERISA does not, as *Holloway I* and the Securities Acts require, compel the disclosure of "relevant, accurate information upon which to base an investment decision." *Holloway I*, 879 F.2d at 786.

It is less clear whether ERISA nonetheless satisfies the information disclosure purpose of the Securities Acts by granting federal regulators sufficient authority to monitor ERISA plans and to take corrective action on behalf of plan "investors." *See id.* The necessary monitoring authority may be provided by virtue of ERISA's requirement that plan administrators file annual reports with the Secretary of Labor. *See* 29 U.S.C. § 1023. The Secretary's authority to enforce ERISA's funding requirements and fiduciary responsibilities on plan administrators by civil or administrative action, *see id.* § 1132(a)(2), (5); *see also id.* §§ 1081-1086 (funding requirements), 1101-1114 (fiduciary duties), also provides federal regulators with some authority to take

[18]Schedule A requires the issuer of a security to provide a potential investor, among other things, with a copy of its most recent balance sheet and profit and loss statement. 15 U.S.C. § 77aa(25), (26).

"corrective action" on behalf of plan participants "to protect their investments." *See Holloway I*, 879 F.2d at 786. In order for this corrective action authority to take the place of the Securities Acts' disclosure provisions, however, it must essentially guarantee the individual's investment. *Holloway I*, 879 F.2d at 788; *Marine Bank*, 455 U.S. at 558-59 (federal banking regulations guaranteeing certificates of deposit displaces federal securities regulation of these certificates). The Secretary's authority to enforce ERISA's funding and fiduciary obligations does not meet this standard with respect to ESOP investments because the value of these investments is entirely dependent on the value of the employer company's stock, and hence on the financial soundness and future prospects of the employer itself, rather than on the employer's continued funding and proper management of plan assets. Accordingly, the Secretary's monitoring and corrective authority under ERISA does not provide "the 'virtual guarantee' necessary to displace the protection of the securities laws" and its disclosure provisions. *Holloway I*, 879 F.2d at 788 (quoting *Marine Bank*, 455 U.S. at 558-59).

Even if the Secretary's monitoring and enforcement authority under ERISA fulfilled the underlying purpose of the Securities Acts' disclosure requirements, we would still find that ERISA does not satisfy *Holloway I's* test for displacement of the Securities Acts because it fails to provide a meaningful remedy to plan participants who allege that plan administrators or promoters acted fraudulently in inducing them to join the plan. *See Holloway I*, 879 F.2d at 786 ("[T]he purposes of the federal securities acts cannot be effectively carried out unless the alternate federal regulation provides for a meaningful [antifraud] remedy to investors.") The Securities Acts provide such a remedy through section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1990), which together authorize private damage actions by investors to recover from persons who make untrue statements of material facts or otherwise act fraudulently

in connection with the purchase or sale of a security. *See Holloway I*, 879 F.2d at 786; *see generally* T. Hazen, The Law of Securities Regulation § 13.2 (2d ed. 1990). The Securities Acts also permit investors fraudulently induced to enter into an investment transaction to rescind that transaction and recover the amount of their investment. *See, e.g., Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 n.4 (9th Cir. 1984); *see generally* Hazen at § 13.7.

Neither the parties nor our research has produced any authority indicating that ERISA provides such a remedy for misrepresentation or other fraudulent acts committed in connection with an individual's decision to join an ERISA-regulated plan. ERISA's civil enforcement provision grants plan participants and beneficiaries the right to bring a private action to recover benefits under a plan, *see* 29 U.S.C. § 1132(a)(1); to enforce ERISA's plan disclosure, funding, and administrative requirements, *see id.* § 1132(a) (3), (4); and to obtain "appropriate relief" for breach of fiduciary duty by an ERISA plan administrator or other person who exercises discretionary control or authority over the plan or its assets. *See id.* §§ 1132(a)(2), 1109 (ERISA liability for breach of fiduciary duty), 1002(21) (defining fiduciary). Only this latter provision regarding breach of fiduciary duty might possibly address fraud committed in connection with an investor's initial decision to join an ERISA plan. Those courts that have considered the issue, however, have held that the fiduciary relationship necessary to state such a claim does not come into existence until an individual becomes an ERISA plan participant, thus denying participants an ERISA remedy for fraud or misrepresentation that occurred before and in connection with their decision to join the plan. *See Isaac v. Life Investors Ins. Co.*, 749 F. Supp. 855, 863 (E.D. Tenn. 1990); *Coleman v. General Elec. Co.*, 643 F. Supp. 1229, 1235 (E.D. Tenn. 1986), *aff'd*, 822 F.2d 59 (6th Cir. 1987); *see also Klank v. Sears, Roebuck & Co.*, 735 F. Supp. 260, 263 (N.D. Ill. 1990) (employee who was neither a plan participant nor a beneficiary could not state an ERISA claim against his

employer for failure to provide him with information regarding participation in the employer's ERISA plan).

Other authority regarding this issue also indicates that ERISA does not provide a remedy for the type of misconduct that is alleged in this case and is prohibited by the Securities Acts.[19] In *Perry v. P*I*E Nationwide, Inc.*, 872 F.2d 157 (6th Cir. 1989), *cert. denied,* 110 S. Ct. 1166 (1990), for example, plaintiffs, like the plaintiffs in this case, were employees of a long-distance motor carrier that successfully solicited them to accept a significant wage reduction in return for participation in an ERISA-regulated ESOP. *Id.* at 158-59. After the company took actions in conflict with representations allegedly made to plaintiffs-employees during the solicitation process, plaintiffs sought rescission of their plan participation and restitution of the agreed wage reduction under theories of common law fraud and misrepresentation. *Id.* at 158-59, 161-62. The defendant employer moved to dismiss the action on the ground that these state law claims were preempted by section 1144(a) of ERISA because they "related to" an ERISA-regulated plan. *See id.* at 158. The district court denied the motion on the ground that plaintiffs' claims related to the manner in which the defendant employer procured plaintiffs' agreement to the wage reduction program rather than to the administration of the ESOP or plaintiffs' benefits under the plan. *Id.* at 159. The Sixth Circuit affirmed this result because "[g]iving plaintiffs the benefit of some doubt in this respect, we are uncer-

[19]Numerous other courts have held that ERISA does not preempt state law claims for fraud in the inducement because such claims are too tenuous and remote to the ERISA plan to be "related to" the plan as required for preemption under section 1144 of the statute. *See, e.g., Perkins v. Time Ins. Co.,* 898 F.2d 470, 473 (5th Cir. 1990); *Martin v. Pate,* 749 F. Supp. 242, 246 (S.D. Ala. 1990); *Greenblatt v. Budd Co.,* 666 F. Supp. 735, 742 (E.D. Pa. 1987); *Miller v. Lay Trucking Co.,* 606 F. Supp. 1326, 1333 (N.D. Ind. 1985). This precedent again suggests that ERISA is not directed to prevention of the sort of pre-participation fraud and misrepresentation that would be actionable under the Securities Acts.

tain whether 29 U.S.C. § 1132 provides, under the circumstances of this case, an adequate remedy to redress the wrongs claimed, specifically, rescission and refund of wage reductions."[20] *Id.* at 162.

Even if ERISA did permit a cause of action for rescission of an employee's participation in a plan and restitution of his or her contributions in cases of fraudulent inducement, there is a split in the circuits as to whether this or any other claim for breach of fiduciary duty can be brought against parties who are not, in fact, plan fiduciaries as defined by ERISA. *Compare Nieto v. Ecker*, 845 F.2d 868, 873 (9th Cir. 1988) (nonfiduciaries are not liable under ERISA) *with Brock v. Hendershott*, 840 F.2d 339, 342 (6th Cir. 1988) (nonfiduciaries are liable under ERISA) and *Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1220 (2d Cir. 1987) (same). ERISA defines a plan fiduciary as a person who

> [1] exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, [2] renders investment advice for a fee or other compensation . . . with respect to any moneys or other property of such plan, or has authority or responsibility to do so, or [3] has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21) (A). Under this definition, at least some of the defendants in this case, including Pepsico and its officers and directors, are likely to be deemed nonfiduciaries under the statute.

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[20]As the Pepsico defendants point out in their supplemental brief, Supplemental Brief for Certain Appellees at 18, this court has previously held that ERISA permits the remedies of rescission and restitution in at least some circumstances. *See Eaves v. Penn*, 587 F.2d 453, 462 (10th Cir. 1978). In that case, however, the court only approved these remedies in the context of a request by plan participants to rescind a plan amendment and to restore funds lost to the plan as a result of the amendment. *See id.* at 463. *Eaves* did not, thereon, concern an attempt under ERISA to rescind participation in a plan or to recover employee contributions to a plan and is thus readily distinguishable from this case.

Given the uncertainty of their amenity to suit under ERISA,[21] it cannot be said that ERISA "abundantly" protects plaintiffs by providing them with a remedy for fraud allegedly committed by these defendants and others in inducing plaintiffs to join the CL ESOP.[22]

As discussed above, *Holloway I* only permits ERISA to displace federal securities regulation of the CL ESOP and other employee benefit plans if ERISA duplicates the protection offered to plaintiffs by the Securities Acts' disclosure and antifraud provisions. ERISA fails both of these tests. Accordingly, we hold that ERISA does not provide sufficient protection to plan participants to displace application of federal securities laws to plaintiffs' interests in the CL ESOP.

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[21]It is possible that the Pepsico defendants could qualify as "parties in interest" with CL, *see* 29 U.S.C. § 1002(14) (defining "party in interest"), such that certain transactions between these parties and CL, as plan administrator, would constitute violations of the statute potentially subject to redress by a court. *See Nieto,* 845 F.2d at 873-74. The parties to this action did not address this possibility, however, and we cannot address it *sua sponte* under the present record.

[22]In their supplemental brief, plaintiffs also suggest that relief may not be available to them under ERISA because there is a split of authority as to whether an employee may bring an ERISA action challenging oral or written misrepresentations regarding an ERISA-regulated plan. *See* Appellants' Supplemental Brief on the Impact of ERISA at 21. In each of the cases cited, however, the issue was whether a plan participant could sue to enforce alleged ERISA plan provisions that were stated either orally or in the plan's summary description but conflicted with the terms of the plan itself. *See, e.g., Straub v. Western Union Tel. Co.,* 851 F.2d 1262, 1265 (10th Cir. 1988) (oral modification); *Nachwalter v. Christie,* 805 F.2d 956, 960 (11th Cir. 1986) (same); *Gors v. Venoy Palmer Market, Inc.,* 578 F. Supp. 365, 368 (E.D. Mich. 1984) (conflict between summary description and plan itself); *O'Brien v. Sperry Univac,* 458 F. Supp. 1179, 1180 (D.D.C. 1978) (same). In this case, plaintiffs are suing to rescind their participation in a plan based on alleged oral misrepresentations, rather than suing to enforce those representations. Thus, to the extent that there is a split among the circuits regarding the effect of oral or written representations on plan terms and conditions, it is irrelevant to the issue before this court.

b. Continued federal regulation of voluntary, contributory employee benefit plans under both ERISA and the Securities Acts

Plaintiffs also argue in the alternative that even if ERISA duplicates the investor protection provided to plaintiffs by the Securities Acts, this duplication has no effect on the "securities" status of interests in voluntary, contributory employee benefit plans such as the CL ESOP. They base this claim on the SEC's assertion, even after ERISA, that these types of plans continue to be subject to regulation under the Securities Acts. *See, e.g.*, SEC Release No. 33-6188 at 2073-9 to 2073-11. As noted earlier, this agency interpretation of its regulatory authority is entitled to considerable weight unless it violates "the clear meaning of [the] statute, as revealed by its language, purpose, and history."[23] *Daniel*, 439 U.S. at 566 n.20; *see also National Ass'n of Sec. Dealers*, 422 U.S. at 719.

In fact, there is evidence that Congress intended for the SEC to continue regulating employee benefit plans that qualified as securities even after ERISA. In ERISA itself, for example, Congress expressly excluded state securities regulation from preemption under the statute, thus permitting states that had followed the SEC in finding interests in voluntary, contributory plans to be securities to continue in this practice.[24] *See* 29 U.S.C.

[23]We disagree with the SEC's contention, however, that all voluntary, contributory employee benefit plans qualify as investment contracts under *Howey*. The voluntary, contributory aspect of such plans satisfies *Howey*'s "investment of money" requirement, but is not determinative of each plan's compliance with *Howey*'s final requirement that profits from this investment result from the efforts of others. *See Howey*, 328 U.S. at 301. Depending on the specific terms of the plan, therefore, some voluntary, contributory employee interests will not qualify as investment contracts under the *Howey* text. *See* n.10 *supra* and accompanying text.

[24]As plaintiffs point out, it makes little sense for Congress to have permitted the states this latitude while intending that ERISA preempt federal securities regulation of interests in these same types of plans.

§ 1144(b)(2)(A). In section 1144(d), Congress further provided that ERISA was not intended to supersede any existing federal law, thus allowing the SEC to continue regulating qualifying employee benefit plans as it always had. *See id.* § 1144(d). In 1979, Congress also considered and rejected a bill that, among other provisions, would have amended ERISA to specifically remove interests in employee benefit plans from the definition of "security" for purposes of the antifraud provisions of the Securities Acts. *See* S. 209, 96th Cong., 1st Sess. (Feb. 8, 1979). These congressional actions are consistent with the SEC's determination that at least some voluntary, contributory plans are investment contracts subject to federal securities regulation and support plaintiffs' claim that Congress knew and approved of continued SEC regulation of such plans when it enacted ERISA in 1974. We therefore hold that even if ERISA duplicates the investor protection offered by the Securities Acts to the plaintiffs in this case, this alternate federal regulation does not prevent plaintiffs from establishing that their interests in the voluntary, contributory CL ESOP are securities or bar them from invoking the Securities Acts to protect these interests.

The Pepsico defendants again rely on the Supreme Court's decision in *Daniel* to argue against both this result and our general holding that ERISA has no effect on the status of plaintiffs' ESOP interests as securities. In particular, these defendants maintain that *Daniel* essentially decided that interests in all employee benefit plans, including voluntary, contributory plans, are not subject to regulation under the Securities Acts. This position is based on the Court's statements concerning ERISA's effect on the status of involuntary, noncontributory pension plans under the Securities Acts:

> If any further evidence were needed to demonstrate that pension plans of the type involved [a compulsory, noncontributory plan] are not subject to the Securities Acts, the enactment of ERISA in 1974, would put the matter to rest. Unlike the Securities Acts, ERISA deals expressly and in

> detail with pension plans. ERISA requires pension plans to disclose specified information to employees in a specified manner, in contrast to the indefinite and uncertain disclosure obligations imposed by the antifraud provisions of the Securities Acts. Further, ERISA regulates the substantive terms of pension plans, setting standards for plan funding and limits on the eligibility requirements an employee must meet. For example, with respect to the underlying issue in this case —whether respondent served long enough to receive a pension—§ 203(a) of ERISA now sets the minimum level of benefits an employee must receive after accruing specified years of service, and § 203(b) governs continuous-service requirements. Thus, if respondent had retired after 1053 took effect, the Fund would have been required to pay him at least a partial pension. The Securities Acts, on the other hand, do not purport to set the substantive terms of financial transactions.
>
> The existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. Congress believed that it was filling a regulatory void when it enacted ERISA, a belief which the SEC actively encouraged. Not only is the extension of the Securities Acts by the court below unsupported by the language and history of those Acts, but in light of ERISA it serves no general purpose. Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA.
>
> We hold that the Securities Acts do not apply to a noncontributory, compulsory pension plan.

Daniel, 439 U.S. at 569-70 (citations omitted).

Contrary to the Pepsico defendants' assertion, this language indicates that *Daniel*'s ultimate holding, as well as most of its statements regarding the interplay between ERISA and the Securities Acts, are limited to the status of noncontributory, compulsory plans under these Acts. To the extent that the Court's broader statements comparing ERISA and the Acts' disclosure

and remedial provisions are more than dicta, they are also distinguishable from this case because of the differences between the claims made in *Daniel* and those made here. In *Daniel*, the plaintiff was seeking to recover benefits under a pension plan on the grounds that the defendants had misrepresented certain aspects of his eligibility for plan benefits. *See* 439 U.S. at 554-555, 569. As the Supreme Court noted in the language quoted above, this is precisely the type of claim that ERISA is intended to address. In this case, on the other hand, plaintiffs seek return of their investment in the CL ESOP, rather than a determination of the benefits due them under that benefit plan, on the ground that defendants committed fraud in inducing them initially to enter into the plan. As described earlier in this opinion, ERISA does not provide a remedy for this type of fraudulent behavior. Accordingly, *Daniel* does not require us to hold that ERISA provides such ample investor protection to plaintiffs' interests in the CL ESOP that it displaces regulation of these interests under the Securities Acts.

B. Other Issues on Appeal

Both plaintiffs and the Pepsico defendants also raise a number of additional issues on appeal. Plaintiffs first contend that the district court erred by dismissing their claims under the Oklahoma Securities Act on grounds of federal preemption, and then urge us to hold, as a matter of law, that their ESOP interests are securities under this act. The record, however, indicates that the district court dismissed plaintiffs' state security claims upon finding no basis for federal jurisdiction after dismissal of the federal securities claims, rather than on the basis of federal preemption. 1988 Order at 14-15. Given this record and our holding that dismissal of these federal claims was error, we reverse and remand the district court's dismissal of the state securities claims without reaching plaintiffs' contentions regarding the status of their ESOP interests under Oklahoma securities law.

The plaintiffs also assert that the district court abused its discretion in prohibiting them from introducing evidence at trial concerning the profit-sharing component of the Wage Reduction Program. As plaintiffs implicitly admit in their brief, their request to admit evidence on this point amounted to a request for leave to amend their complaint. *See* Brief of Petitioner at 43-45. Although leave to amend "shall be freely given when justice so requires," Fed. R. Civ. P. 15(a), whether leave should be granted is left to the trial court's discretion. *Las Vegas Ice & Cold Storage Co.*, 893 P.2d at 1185. In this case, plaintiffs had twice been granted leave to amend their complaint before this last request. The issues to be resolved at trial had been set for more than a year and trial was scheduled to begin in three months. Given these facts, we will not say that the district court abused its discretion in denying plaintiffs leave to amend. *See id.* (untimeliness alone may be a sufficient basis for denial of leave to amend).

Plaintiffs' final claim on appeal is that the district court abused its discretion when it excluded certain of plaintiffs' exhibits, namely a series of payroll slips, from trial on the ground that they had not been designated as trial exhibits as required by a pretrial order. In light of the clear wording of the pretrial order, we find no abuse of discretion in this ruling.[25]

The Pepsico defendants also cross-appeal the district court's denial of their post-trial motion for costs and fees pursuant to 28 U.S.C. § 1927 and Rule 11 of the Federal Rules of Civil Procedure. These defendants allege that they are entitled to such costs and fees due to the plaintiffs' persistence in asserting that their wage reductions were paid into or otherwise contributed to the CL ESOP and that they made a voluntary investment decision. Given our determination on appeal that both of these statements were correct as a matter of law, we find no abuse of discretion in the district court's refusal to award sanctions.

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[25]Of course, neither the parties nor the district court is precluded for revisiting these pleading and evidentiary issues on remand of this matter.

The judgment of the United States District Court for the Western District of Oklahoma is therefore AFFIRMED with respect to its determination of the pleading, evidentiary and sanction issues discussed above. The district court's dismissal of plaintiff's federal and state securities claims is REVERSED, however, and this matter is REMANDED for additional proceedings consistent with this opinion.

APPENDIX B

IN THE

United States District Court

FOR THE

Western District of Oklahoma

WILLIAM T. USELTON, *et al.*, *Plaintiffs,* v. COMMERCIAL LOVELACE MOTOR FREIGHT, et al., *Defendants.*	Case No. CIV-84-2807-A **ORDER**

I.

INTRODUCTION

This case presents the issue of whether an employee stock option plan ("ESOP"), which was presented to the employees of Lee Way Motor Freight in an effort to save the company and sustain the jobs of its employees, constitutes a "security" within the meaning of federal securities law. The Court concludes that the circumstances of this case create no basis for a violation of the federal securities laws, and as a result, Plaintiffs' case must be dismissed.

The trial of this case was governed by two orders, one entered by Judge Wayne E. Alley on August 1, 1986, and the other entered by the undersigned on August 5, 1987.[1] The former order identified the issues to be tried in the case, while the latter order identified the schedule under which the parties were to prepare these issues for trial.

By agreement of the parties, this case proceeded to trial before the Court on December 2-4, 1987. Pursuant to the pretrial

[1]The case was transferred to the undersigned on June 22, 1987.

orders, the legal issue before the Court was whether participation in the ESOP constituted a security within the meaning of Section 2(1) of the Securities Act of 1933 or Section 3 of the Securities Exchange Act of 1934. The Court has laboriously reviewed the voluminous affidavits, transcripts, exhibits and testimony of this case, as well as the exhaustive briefs filed by all parties. Although the case was aggressively and professionally pursued by all counsel, the evidence at trial overwhelmingly established that the employees of Lee Way Motor Freight did *not* purchase a security by participating in the Commercial Lovelace Motor Freight ESOP ("CL ESOP").

Pursuant to the pretrial orders in this case, the plaintiff employees undertook a heavy burden. Specifically, plaintiffs were required to prove the following:

1) that the employees contributed to the CL ESOP;

2) that the employees' participation in the CL ESOP was voluntary;

3) that participation in the CL ESOP fell within the definition of a security.

After a careful review of the evidence, the Court finds Plaintiffs' case to be defective on all three scores. In support of this conclusion, the Court enters the following Findings of Fact and Conclusions of Law.[2]

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[2]Much of the evidencve in the case was based upon depositions, undisputed contentions, and stipulated facts, thus rendering unnecessary detailed findings on the issue of credibility within the meaning of Federal Rule of Civil Procedure 52(a). Moreover, the Court is aware of the standards governing the review of this case, namely that "where there are two permissible views of the evidence, the fact finder's choice between them cannot be clearly erroneous." See *Sawyer v. Swift and Company*, F.2d (No. 85-2801) (10th Cir. Jan. 7, 1988). In this case, however, while some credibility determinations were necessary, the evidence critical to the legal issues before the Court was virtually one-sided.

II.

FINDINGS OF FACT

A. Stipulated Facts

Pursuant to this Court's Order of August 5, 1987, the parties entered into a comprehensive stipulation of uncontested facts ("stipulation"), which was filed with the Court on August 17, 1987. The Court hereby adopts and incorporates this stipulation in its entirety as part of the Court's Findings of Fact. For purposes of clarity, many of the stipulated facts are reiterated in the findings which follow. A copy of this stipulation is attached to this Order.

B. Disputed Findings of Fact—Background

On December 16, 1987, following the trial of this matter the parties filed revised findings of fact, conforming their previously filed proposed findings to the evidence presented at trial. On December 24, 1987, the parties filed objections to the revised findings. As a result of this process a number of the proposed findings were undisputed. Although overlapping in many respects with the stipulated facts, the Court hereby includes the following undisputed findings as part of its findings of fact.[3]

1. Pursuant to Federal Rule of Civil Procedure 42(b), this matter was segmented for trial on the limited issue of whether participation in an employee stock ownership plan implemented by the Defendant Commercial Lovelace Motor Freight and extended to employees of Lee Way Motor Freight constituted a security

[3]The undisputed proposed findings of fact filed by Plaintiff on December 16, 1987 are designated as PPFI # . The undisputed proposed findings of fact filed by defendants Pepsico, Inc., Lawrence Dickie, James English, Judy Davis, Richard Campbell and Sharon Shroeder are designated as PEPF # . The undisputed proposed findings of fact filed by defendants M.T. Alcox, W.D. Persavich, C.C. McCracken, V.L. Ingrum, H.L. Hill and G.W. McIntyre are designated as ALPF # .

within the meaning of Section 2(1) of the Securities Act of 1933, 15 U.S.C. §77b(1), or Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10). [PEPF #1].

2. The Plaintiffs are former employees of Lee Way Motor Freight, Inc. ("Lee Way"). [PEPF #2].

3. Commercial Lovelace Motor Freight, Inc. ("CL") was a Delaware corporation with its principal place of business in Columbus, Ohio. [PPF #3].

4. Lee Way Motor Freight, Inc. ("Lee Way") was a Delaware corporation with its principal place of business in Oklahoma City, Oklahoma, who at all relevant times employed the Plaintiffs in the present case. [PPF #4].

5. Defendants James English, Lawrence F. Dickie, Judy Norman-Davis, Richard Campbell, and Sharon Schroder are alleged to have been members of the Board of Directors of Pepsico at all relevant times, which they deny. This Court need not resolve this factual dispute. [PEPF #3].

6. The Defendants M.T. Alcox, W.D. Persavich, C.C. McCracken, V.L. Ingrum, H.L. Hill, and G.W. McIntyre are alleged to have been individual officers of CL and/or Lee Way. The Defendants V.L. Ingrum and H.L. Hill, although named in the original Complaint, were not named as defendants in the Plaintiffs' Second Amended Complaint. [PEPF #8].

7. Both Lee Way and CL were, at all relevant times, common carriers engaged in the interstate and intrastate transportation of commodities. As common carriers, both were subject to certain regulations of the Interstate Commerce Commission. [PPF #5].

8. Prior to 1976, Lee Way was a publicly owned trucking company. However, in 1976, it was acquired by Defendant Pepsico and remained a wholly-owned subsidiary corporation until the ownership of Lee Way passed to Defendant CL. [PPF #6].

9. In early 1984, Defendant Pepsico and CL entered into negotiations for Defendant CL to buy all of the stock in Lee Way from Defendant Pepsico. The parties arrived at an accord and signed a Stock Purchase Agreement dated May 22, 1984. [PPF #7].

10. However, the sale of Lee Way had to be approved by the Interstate Commerce Commission. While approval by the ICC was pending, the Stock Purchase Agreement required Defendant Pepsico to deposit the shares of Lee Way in escrow. [PPF #8].

11. The necessary approval for the sale of Lee Way was obtained from the ICC on August 6, 1984 and title to Lee Way was delivered from escrow to CL. [PPF #10].

12 On February 27, 1985, Lee Way was merged into CL. The resulting entity, Lee Way Holding Company, Inc. ("LWHC"), filed for bankruptcy relief under Title 11 of the United States Code on March 7, 1985. These proceedings have been stayed as to CL and Lee Way. [PEPF #7].

To the extent that other undisputed facts appear in other sections of these findings, they will be designated in accordance with the format set forth in footnote 3 of this opinion and labeled "undisputed".

C. The Compensation/Wage Reduction Program

13. In June 1984, CL began an effort to solicit participation of Lee Way employees in a program which was implemented by CL in 1983. [PEPF #12 (undisputed in part); stipulation at ¶ 9, 17, 18].

14. The terms of the compensation program implemented at Lee Way were identical to the terms of the compensation program implemented by CL in 1983. Non-union salaried employees were required to participate in the compensation program as a condition of their employment, but union employees had to

execute consent forms in order to participate. [PEPF #13 (undisputed); Stipulation at ¶ 9, 18].

15. There were three parts to the compensation program. The first part was a reduction in the wages of participating employees by 17.355%. (Stipulation at par. 9).

16. The second part of the compensation program was the adoption of a cash profit sharing bonus plan whereby participating employees automatically became entitled to receive 20% of any consolidated pre-tax profits earned by CL for a period of time. [PEPF #15 (undisputed); Stipulation at par. 10].

17. The third part of the compensation program was the establishment of an employee stock ownership plan in CL common stock (the "CL ESOP"). Participants in the compensation program became eligible to participate in the CL ESOP. (Stipulation at par. 11).

D. The ESOP

18. The Internal Revenue Service determined that the CL ESOP was a qualified employee stock ownership plan under Section 401(a) and 4975(e)(7) of the Internal Revenue Code. [PEPF #17 (undisputed factually); Court Ex. 24; Affidavit of William C. Buckham), par. 6; Exhibit F to Court Ex. 24].

19. The CL ESOP is subject to the provisions of the Employee Retirement Income Security Act ("ERISA"). [PEPF #18 (undisputed); Stipulation at par. 15].

20. To fund the CL ESOP, CL, in 1983, issued 4,001,000 shares of its common stock, representing 50.01% of its common stock, to Central National Bank of Cleveland, Ohio as Trustee. Except for the nominal sum of $100 deposited by CL in the CL ESOP Trust in connection with its establishment, the sole consideration for the CL shares was $750,000, evidenced by five promissory

notes (the "Trust Notes") from the Trustee, each in the amount of $150,000, payable to the order of CL. The five Trust Notes were to mature serially on the last day of February during the years 1984 through 1988. Initially, CL held all of the CL shares in pledge as security for the Trust Notes. [PEPF #20 (undisputed); Stipulation at par. 12; Court Ex. 19].

21. The provisions of the CL ESOP contemplated, and the Loan and Pledge Agreement between the Trustee and CL expressly provided, that annually CL would either forgive the Trust Note then maturing or make a cash contribution to the CL ESOP in the amount of the Trust Note and that the Trustee would then pay off the Trust Note by redelivering the funds to CL. The CL ESOP provided that once a Trust Note was paid in either manner, 800,000 shares of CL stock would be released from the pledge and allocated to the account of CL ESOP participants in accordance with the formula provided by the CL ESOP. [PEPF #21 (undisputed in part); Stipulation at par. 13; Court Ex. 19, Affidavit of James McGuire, par. 4; Plaintiff Ex. 9, pp. 6-7].

22. Pursuant to the terms of the CL ESOP, allocations of CL stock to a participant's account was based upon the ratio that the compensation of all participants bore to the total compensation of all participants for a given year. [ALPF #22 (undisputed)].

23. Such allocations were made to accounts maintained by the CL ESOP Trustee. [PEPF #22 (undisputed in part)]. Those accounts never contained any funds. Rather, they contained only allocated stock. (Testimony of Gerard McIntyre, 12-3-87 Transcript, pp. 104, 117).

24. In February, 1984, CL contributed a check in the amount of $149,900 to the Trustee. Consequently, 800,000 shares of CL were released and allocated to the participants' account [PEPF #24 (undisputed in part); Stipulation at par. 13; Count Ex. 19, Affidavit of James McGuire), par. 4; Court Ex. 24A, Deposition of William C. Buckham].

25. In 1985, CL cancelled the Trust Note owed to it by the CL ESOP Trustee. Accordingly, 800,000 shares of CL stock were released from allocation to participants' accounts, including the accounts of Lee Way employees who had become participants in the compensation program. [PEPF #25 (undisputed); Stipulation at par. 13; Court Ex. 19, Affidavit of James McGuire, par. 4].

26. Section 4(e) of the CL ESOP provides that "no participant shall be required or permitted to make contributions to the trust." [ALPF #27 (undisputed); CL Exhibit A].

27. No employee contributions were made to the CL ESOP. [Testimony and affidavit of Sharon Schroder and J. McGuire]. Although the employees' pay checks were reduced as a result of the compensation program, no monies resulting from these reductions were ever transferred to the CL ESOP. Moreover, following the purchase of Lee Way by CL, no additional contributions were made to the trust by CL or Lee Way. [Testimony of J. McGuire, S. Schroder, and Stipulation at par. 14].

28. No CL shares have ever been purchased on the open market by the Trustee, nor have any CL shares been acquired by the Trust, except the shares issued by CL to the Trustee at the inception of the CL ESOP [PEPF #32 (undisputed); Stipulation at par. 16].

E. The Presentation/Implementation of the Program

32. Beginning in June 1984, representatives of CL, including Gerard McIntyre, then president and chief executive officer of CL, William C. Buckham, then Vice President—Administration, secretary and general counsel of CL, presented the compensation program to employees of Lee Way. [PEPF #33 (undisputed); Stipulation at par. 17, 18; Court Exhibit #20; McIntyre Aff. par. 6; Court Exhibit #24; Buckham Aff. par. 12].

33. The Court was impressed with the care taken by CL management to insure consistent representations were made to the

Lee Way employees concerning the program. Instructions on the content of the representations were given prior to any presentation. A letter dated June 5, 1984 with attachments explaining the program was prepared and disseminated, and steps were taken to insure that the presentations conformed to the instructions and the printed materials. [Testimony and affidavit of Gerard McIntyre, testimony of Linda Farrell; affidavits of Vernon Ingrum and William Buckham]. The gist of CL's message to the Lee Way employees was (1) that Lee Way had suffered major operating losses and that Lee Way needed to decrease expenses in order to continue operating; (2) the employees needed to agree to a reduction in their wages in order to save the company and their jobs; (3) that the reduction in wages would help reduce Lee Way's expenses; and (4) without overwhelming employee participation in the program the company would probably fail. [See *e.g.*, Testimony of G. McIntyre, Linda Farrell, J. Edgemon; Zebdee Hatchett, Franklin Parker].

34. The Court believes that with minor variations, the CL representatives presented the program consistent with the instructions of McIntyre. [Affidavits of G. McIntyre and William Buckham, testimony of Larry Foreman, Linda Farrell]. Indeed, there was convincing proof that the contents of the June 5, 1984 letter were read verbatim at the presentations. *Id*. The credibility of the CL employees who testified to contrary representations was either impaired on cross examination or by the contradicting testimony of their fellow employees. [Compare *e.g.*, testimony of plaintiffs' witnesses William Priest, Kenneth Miles and Bennie Pritner with testimony of plaintiffs' witnesses Linda Farrell and Franklin D. Parker]. Moreover, the printed materials accompanying the presentation strongly corroborate defendant's position and severely undercut plaintiffs' contentions.

35. Although the subject of disputed testimony, the Plaintiffs have not satisfied the Court (by a preponderance of the evidence standard) that CL representatives told the employees that the

money saved as a result of the wage reduction program would be used to buy stock. Indeed, the testimony of virtually all of Plaintiffs' witnesses was to the effect that the employees were in fact told that the reduction was for the purpose of reducing the expenses of Lee Way (and thus by implication *not* for the purpose of taking the saved wage reduction monies and using them to purchase stock). [See *e.g.* Testimony of J. Edgemon, Linda Farrell, Larry Foreman, Zebdee Hatchett, Franklin Parker]. Moreover, virtually all of the Plaintiff witnesses recognized that the proceeds obtained as a result of the wage reduction were not used on their behalf to purchase stock, inasmuch as *none* of the plaintiff witnesses treated the 17.355% reduction as income on their tax returns.

36. FICA deductions from the employees' paychecks were computed on the participating employees' wages *after* the compensation program reduction of 17.355%. Such withholding would have been improper if wage reduction proceeds had been contributed to the CL ESOP. [PEPF #56 (undisputed); Testimony and affidavits of Englebach, Rouse].

37. Lee Way employees who participated in the CL compensation program had their wages reduced by 17.355%. [PEPF #49 (undisputed in part); Testimony of Sharon Schroder]. The 17.355% wage reduction was implemented consistent with the representations of CL employees in that it simply reduced Lee Way's obligation for wages, thereby reducing Lee Way's expenses. The amounts saved as a result of the reduction were not placed in any identifiable fund or paid into the ESOP. [Testimony of S. Schroder, T. Tuck].

38. As to the non-union Lee Way employees who participated in the program, such participation was clearly not voluntary. In fact, participation was a condition of continued employment. [See *e.g.* Testimony of G. Bender; F. Parker, PEPF #50 (undisputed)].

39. Although the subject of dispute at trial, the far greater weight of testimony established that the union employees who participated in the program did not view their participation as voluntary. Indeed, most viewed their options as "no choice at all", but rather the only possible avenue of saving their jobs. To the extent contrary testimony was presented, the credibility of the witnesses in question was either impaired on cross examination [See *e.g.* Testimony of Bennie L. Pritner] or was contradicted by the testimony of fellow employees. [See *e.g.* Testimony of J. Edgemon, K. Miles, T. Tuck, J. Goosetree, L. Foreman].

III.

CONCLUSIONS OF LAW

While the parties have supplied the Court with volumes of briefs on the legal question before the Court, the legal aspects of this case are quite simple in light of the pretrial orders in this case and the evidence presented at trial.

In order for participation in the CL ESOP to constitute a security under the federal securities laws, such participation must (1) be voluntary (2) be contributory and (3) otherwise fit within the definition of a security as set forth in *SEC v. W.J. Howey,* 328 U.S. 293, 301 (1946). [Order of Judge Wayne E. Alley dated August 1, 1986].

As a matter of law, for the reasons set forth in the findings of fact above, the CL ESOP was neither contributory nor voluntary. No employee contributions were permitted to be made to the plan, and in fact none were made. Moreover, the testimony at trial established that the decision to participate in the plan was overwhelmingly non-voluntary. Finally, the plaintiffs' participation in the plan had virtually no characteristics of an investment decision actionable under federal securities law. *International*

Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 559-60 (1979).[4] In short, the participation of Lee Way employees in the CL ESOP did not constitute a security within the meaning of federal securities law. See *Cunha v. Ward Foods, Inc.*, 545 F.Supp. 94 (D. Hawaii 1982).

While the plaintiffs correctly argue that the "economic realities" of a transaction may support the finding of a security, *Woodward v. Terracor,* 574 F.2d 1023, 1024 (10th Cir. 1978), here the economic realities, as reflected by the record evidence, have unquestionably established fundamental flaws in plaintiffs' "security" theory.

Accordingly, judgment is hereby entered on behalf of defendants. There being no other basis for federal jurisdiction of this case, plaintiffs' claims are dismissed in their entirety. The Court will entertain a motion from defendants for reasonable costs and fees, if said motion with supporting documentation is filed within twenty-one days of this Order.

Entered this 29th day of January, 1988.

LAYN R. PHILLIPS
United States District Judge

[4]It should also be noted that neither of the statutes relied upon by plaintiffs [Section 2(1) of the Securities Act of 1933 and Section 3(a)(10) of the Securities Act of 1934] refer to ESOP's in their definition of security.

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

WILLIAM T. USELTON, *et al.*,
Plaintiffs,

v.

COMMERCIAL LOVELACE MOTOR FREIGHT, INC., *et al.*,
Defendants.

No. CIV-84-2807-P

STIPULATED FACTS

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IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

WILLIAM T. USELTON, *et al.*, *Plaintiffs,* v. COMMERCIAL LOVELACE MOTOR FREIGHT, INC., *et al.*, *Defendants.*	No. CIV-84-2807-P

STIPULATED FACTS

1. The Second Amended Complaint lists in its caption more than 460 plaintiffs, who are former Union employees of Lee Way Motor Freight, Inc.

2. At the time this action was filed, the defendant, PepsiCo, Inc., was a Delaware Corporation, with its principal place of business in Purchase, New York.

3. The defendant, Commercial Lovelace Motor Freight, Inc., a/k/a CL Motor Freight (hereinafter referred to as "CL"), was a Delaware Corporation, with its principal place of business in Columbus, Ohio.

4. Lee Way Motor Freight, Inc. (hereinafter referred to as "Lee Way"), was a Delaware Corporation, with its principal place of business in Oklahoma City, Oklahoma.

5. Both Lee Way and CL were, at all relevant times, common carriers engaged in the interstate and intrastate transportation of commodities. As common carriers, both were subject to regulation by the Interstate Commerce Commission.

6. Prior to 1976, Lee Way was a privately owned trucking company. It was acquired by PepsiCo in 1976 and remained a wholly owned subsidiary until 1984 when it was sold by PepsiCo

to CL, pursuant to the terms of a Stock Purchase Agreement dated May 22, 1984, which closed in escrow on June 6, 1984.

7. The sale of Lee Way required the approval of the Interstate Commerce Commission, which was obtained on August 6, 1984.

8. As a result of, among other things, deregulation following the passage of the Motor Carrier Act of 1980, a series of measures designed to reduce operating losses substantially were undertaken at CL. One of these measures was a cost reduction program, consisting of three parts.

9. The first part of the cost reduction program implemented by CL in 1983 prior to its acquiring Lee Way was a wage reduction program reducing employees' wages in an amount of 17.355%. Participation in the salary reduction program by union employees was by consent. This program was compulsory as to non-union salaried employees; however, pursuant to the Union Collective Bargaining Agreement, the reduction program could not be compulsory for union employees.

10. The second part of the 1983 CL program was the adoption of a cash profit sharing bonus plan whereby employees participating in the wage and salary reduction program automatically became entitled to receive 20% of any consolidated pre-tax profits earned by CL for a period of time.

11. The third part in the 1983 CL program was the establishment of an Employee Stock Ownership Plan ["ESOP"]. All participants in the CL wage and salary reduction program automatically became participants in the ESOP.

12. To fund the ESOP, CL issued common shares representing 50.01% of its stock, or 4,001,000 shares, to Central National Bank of Cleveland, Ohio, as Trustee. Except for the nominal sum of $100.00 deposited by CL in the ESOP Trust in connection with

its establishment, the sole consideration for the CL shares consisted of $750,000.00, evidenced by five Trust Notes payable to CL in the amount of $150,000.00 each. The five Trust Notes were to mature serially on the last day of February during the years 1984 through 1988. Initially CL held all of the CL shares in pledge as security for the Trust Notes.

13. The provisions of the CL ESOP stated that annually CL would forgive the serial note then maturing or that CL would contribute cash to the Trustee to be used to pay the maturing trust note. The ESOP agreement provided that once a note was paid in either manner, 800,000 shares of CL stock would be released from the pledge and allocated to the accounts of ESOP participants in accordance with the formula provided by the Plan. During the two years of the operation of the Plan, this in fact occurred. In 1984 CL contributed the cash to the Trustee to pay off the note. CL contributed $149,000 used to pay off the note. In 1985 CL merely cancelled the 1985 note. 1,600,000 shares were released from the pledge and allocated to ESOP participants' accounts, including the accounts of those Lee Way employees who had become participants in the Plan.

14. The written ESOP provides that no employee would be required or permitted to make any contributions to the ESOP Trust. The parties are in dispute as to whether the Plan was followed in this respect. The parties are in agreement that aside from the initial deposit of $100., the sole contributions to the ESOP Trust were made as set forth in the Affidavit of the ESOP Trustee, James L. McGuire, dated October 25, 1985.

15. The CL ESOP is subject to the provisions of ERISA, pursuant to which CL has prepared and distributed annually to participants copies of a Summary Plan Description relating to the CL ESOP.

16. No CL shares have ever been purchased on the open market by the Trustee, nor have any CL shares been acquired by the

Trust, except the shares issued by CL to the Trustee at the inception of the ESOP.

17. In connection with the purchase of Lee Way, it was determined that the wage reduction already in effect with CL would be extended to Lee Way employees. Efforts to sign up Lee Way employees began in June, 1984, while Lee Way was being operated by CL pursuant to the Management Agreement dated May 22, 1984, and while the stock of Lee Way was in escrow pending final I.C.C. approval of the transaction.

18. The terms of participation in the CL ESOP as part of the compensation program at Lee Way, were identical to the terms of the compensation programs at CL. The program was mandatory as to non-union salaried employees but consensual as to union employees. CL management held meetings with Lee Way's union employees for the purpose of explaining the entire cost reduction program.

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APPENDIX C

IN THE

United States District Court

FOR THE

WESTERN DISTRICT OF OKLAHOMA

W. D. HUPP, et al.,

Plaintiffs,

v.

COMMERCIAL LOVELACE MOTOR FREIGHT, et al.,

Defendants.

No. CIV-84-2807-A

ORDER

A number of motions are at issue on the question whether the employee stock option plan (ESOP) in this case is a security. The Court hereby denies all Motions for Summary Judgment or Dismissal with respect to the proposition that it is shown without genuine issue of material fact that the ESOP is not a security.

The trial of this case will be segmented pursuant to F.R.Civ.P. 42(b). The first phase of the trial will be limited to factual issues as to whether the ESOP is a security. In this connection, the Court has ruled:

1. To be a security the ESOP program must be a voluntary contributory plan and must otherwise fit within the definition of security.

2. "Contributory" plan means that the workers must be making payments into and enhancing the ESOP corpus, although these payments may be accomplished through some accounting system set up by the employer, the ESOP Trust or otherwise.

3. Neither lump sum or periodic payments on behalf of the workers made by others will suffice for a contributory plan.

4. A mere showing that the employer obtained relief from its overhead obligation for wages, creating a savings from which it paid down the ESOP note, will not suffice.

Following discussion between counsel and the Court, the Court will entertain a motion from plaintiffs for additional discovery on the Phase 1 issues if such motion is on file within ten days after July 30, 1986. In that discovery on this very issue was previously made available for plaintiffs in connection with the several motions, the Court has ruled that a renewed discovery motion on the issue must be specific with respect to discovery "leads," information sought, and the source. Defendants will have ten days from the filing of any such discovery motion for response.

The parties will confer as to the mode of trial for Phase 1, bench or jury, and seek to reach agreement by August 7, 1986. If agreement is not reached and if defendants oppose a jury trial, defendants will notify the Court not later than August 14, 1986.

IT IS SO ORDERED this 1st day of August, 1986.

WAYNE E. ALLEY
United States District Judge